104th Congress, 2d Session – – – – – – – – – – – – House Document 104–221

PROPOSED LEGISLATION: "RETIREMENT SAVINGS AND SECURITY ACT"

MESSAGE

FROM

THE PRESIDENT OF THE UNITED STATES

TRANSMITTING

A DRAFT OF PROPOSED LEGISLATION TO PROVIDE FOR RETIREMENT SAVINGS AND SECURITY

MAY 23, 1996.—Message and accompanying papers referred to the Committees on Ways and Means, Economic and Educational Opportunities, Government Reform and Oversight, and Transportation and Infrastructure and ordered to be printed

U.S. GOVERNMENT PRINTING OFFICE

24–743 WASHINGTON : 1996

To the Congress of the United States:

I am pleased to transmit today for the consideration of the Congress the "Retirement Savings and Security Act." This legislation is designed to empower all Americans to save for their retirement by expanding pension coverage, increasing portability, and enhancing security. By using both employer and individual tax-advantaged retirement savings programs, Americans can benefit from the opportunities of our changing economy while assuring themselves and their families greater security for the future. A general explanation of the Act accompanies this transmittal.

Today, over 58 million American public and private sector workers are covered by employer-sponsored pension or retirement savings plans. Millions more have been able to save through Individual Retirement Accounts (IRAs). The Retirement Savings and Security Act would help expand pensions to the over 51 million American private-sector workers—including over three-quarters of the workers in small businesses—who are not covered by an employer-sponsored pension or retirement savings program and need both the opportunity and encouragement to start saving. Women particularly need this expanded coverage: fewer than one-third of all women retirees who are 55 or older receive pension benefits, compared with 55 percent of male retirees.

The Act would also help the many workers who participate in pension plans to continue to save when they change jobs. It would reassure all workers who save through employer-sponsored plans that the money they have saved, as well as that put aside by employers on their behalf, will be there when they need it.

The Retirement Savings and Security Act would:

- Establish a simple new small business 401(k)-type plan—the National Employee Savings Trust (NEST)—and simplify complex pension laws. The NEST is specifically designed to ensure participation by low- and moderate-wage workers, who will be able to save up to $5,000 per year tax-deferred, plus receive employer contributions toward retirement. The Act would encourage employers of all sizes to cover employees under retirement plans, and it would enable employers to put more money into benefits and less into paying lawyers, accountants, consultants, and actuaries.
- Increase the ability of workers to save for retirement from their first day on the job by removing barriers to pension portability. In particular, employers would be encouraged no longer to require a 1-year wait before employees can contribute to their pension plans. The Federal Government would set the example for other employers by allowing its new employees to begin saving through the Thrift Savings Plan when they are hired, rather than having to wait up to a year. In addition, the Act would reduce from 10 to 5 years the time those participat-

ing in multiemployer plans—union plans where workers move from job to job—must work to receive vested benefits. It would also help ensure that returning veterans retain pension benefits and that workers receive their retirement savings even when a previous employer is no longer in existence.

- Expand eligibility for tax-deductible IRAs to 20 million more families. In addition, the Act would encourage savings by making the use of IRAs more flexible by allowing penalty-free withdrawals for education and training, purchase of a first home, catastrophic medical expenses, and long-term unemployment. It would also provide an additional IRA option that provides tax-free distribution instead of tax-deductible contributions.
- Enhance pension security by protecting the savings of millions of State and local workers from their employer's bankruptcy, as happened in Orange County, California. The Act would (1) require prompt reporting by plan administrators and accountants of any serious and egregious misuse of funds; (2) double the guaranteed benefit for participants in multiemployer plans in the unlikely event such a plan becomes insolvent; and (3) enhance benefits of a surviving spouse and dependents under the Civil Service Retirement System and the Railroad Retirement System.
- Ensure that pension raiding, such as that which drained $20 billion out of retirement funds in the 1980s, never happens again—by retaining the strong current laws preventing such abuses and by requiring periodic reports on reversions by the Secretary of Labor.

Many of the provisions of the Retirement Savings and Security Act are new. In particular, provisions facilitating saving from the first day on the job, in both the private sector and the Federal Government; the doubling of the multiemployer guarantee; and improving benefits for surviving spouses and dependents of participants in the Civil Service Retirement System and the Railroad Retirement System deserve special consideration by the Congress. In addition, many of the provisions and concepts in this Act have been previously proposed by this Administration and have broad bipartisan support.

American workers deserve pension security—as well as a decent wage, lifelong access to high quality education and training, and health security—to take advantage of the opportunities of our growing economy.

I urge the prompt and favorable consideration of this legislative proposal by the Congress.

WILLIAM J. CLINTON.

THE WHITE HOUSE, *May 23, 1996.*

104TH CONGRESS
2D SESSION

H. R. _____

IN THE HOUSE OF REPRESENTATIVES

Mr. ____ introduced the following bill; which was referred to the Committee on _____

A BILL

To provide for retirement savings and security.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE; TABLE OF CONTENTS.

(a) SHORT TITLE.—This Act may be cited as the "Retirement Savings and Security Act".

(b) TABLE OF CONTENTS.—

TITLE I—REVENUE PROVISIONS

SEC. 1100. AMENDMENT OF 1986 CODE.

Except as otherwise expressly provided, whenever in this title an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1986.

Subtitle A—Expanded Pension Coverage and Simplification

CHAPTER 1—THE NEST AND OTHER COVERAGE EXPANSION

SEC. 1101. ESTABLISHMENT OF NATIONAL EMPLOYEE SAVINGS TRUSTS FOR EMPLOYEES OF SMALL EMPLOYERS.

(a) IN GENERAL.—Section 408 (relating to individual retirement accounts) is amended by redesignating subsection (p) as subsection (q) and by inserting after subsection (o) the following new subsection:

"(p) NESTs.—

"(1) IN GENERAL.—For purposes of this title, the term 'NEST' means an individual retirement account or annuity established under a written plan of an eligible employer—

"(A) which meets the requirements of paragraphs (4), (5), (6), (7), and (8), and

"(B) under which contributions are made to NESTs solely in accordance with a qualified formula.

"(2) QUALIFIED FORMULA.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'qualified formula' means a contribution formula which meets the requirements for—

"(i) a 3-percent formula under subparagraph (B), or

"(ii) a matching-contribution formula under subparagraph (C).

"(B) 3-PERCENT FORMULA.—

"(i) NONELECTIVE CONTRIBUTIONS.—The requirements of the 3-percent formula are met if, pursuant to the terms of the plan, the employer makes nonelective contributions of 3 percent of compensation for each eligible employee who has at least $5,000 of compensation from the employer for the year.

"(ii) ELECTIVE CONTRIBUTIONS.—A plan shall not fail to meet the requirements of this subparagraph merely because, pursuant to the terms of the plan, an eligible employee may elect to have the employer make payments—

"(I) as elective contributions to the NEST on behalf of the employee, or

"(II) to the employee directly in cash.

"(C) MATCHING-CONTRIBUTION FORMULA.—The requirements of the matching-contribution formula are met if, pursuant to the terms of the plan—

"(i) the employer makes nonelective contributions of 1 percent of compensation for each eligible employee who has at least $5,000 of compensation from the employer for the year,

"(ii) an eligible employee may elect to have the employer make payments—

"(I) as elective contributions to the NEST on behalf of the employee, or

"(II) to the employee directly in cash, and

"(iii) the employer makes matching contributions on behalf of each eligible employee in an amount equal to—

"(I) 100 percent of the elective contributions of the employee to the extent such elective contributions do

not exceed 3 percent of the employee's compensation, and

"(II) a uniform percentage (which is at least 50 percent but not more than 100 percent) of the elective contributions of the employee to the extent that such elective contributions exceed 3 percent but do not exceed 5 percent of the employee's compensation.

"(D) DISCRETIONARY CONTRIBUTIONS.—A plan shall not be treated as failing to meet the requirements of this paragraph merely because, pursuant to the terms of the plan, an employer makes nonelective contributions under subparagraph (B)(i) or (C)(i) in excess of 3 percent or 1 percent of compensation, respectively, but only if all such contributions bear a uniform relationship to the compensation of each eligible employee and do not exceed 5 percent of compensation for any eligible employee.

"(E) LIMITATION ON ELECTIVE CONTRIBUTIONS.—Elective contributions to a NEST under subparagraph (B)(ii) or (C)(ii) shall not be treated as made pursuant to a qualified for-

mula if such contributions on behalf of any employee for a year exceed the greater of $5,000 or one-half of the limitation applicable for the year to elective deferrals under section 402(g).

"(F) COMPENSATION LIMIT.—Contributions to a NEST shall not be treated as made pursuant to a qualified formula if the annual compensation taken into account for any employee under the formula exceeds the limitation imposed by section 401(a)(17).

"(G) LOWER COMPENSATION THRESHOLD PERMITTED.—A plan shall not be treated as failing to meet the requirements of this paragraph merely because, pursuant to the terms of the plan, an employer makes nonelective contributions under subparagraph (B)(i) or (C)(i) to each eligible employee who has compensation from the employer for the year in excess of a uniform compensation threshold which is less than $5,000.

"(H) For purposes of this paragraph—

"(i) IN GENERAL.—The term 'compensation' has the meaning given such term by section 414(q)(3).

"(ii) SELF-EMPLOYED INDIVIDUALS.—Notwithstanding clause (i), in the case of an employee within the meaning of section 401(c)(1), compensation under section 414(q)(3) shall be determined without regard to paragraph (2)(A) (v) and (vi) of section 401(c).

"(3) DEFINITIONS.—For purposes of this subsection—

"(A) ELIGIBLE EMPLOYER.—

"(i) IN GENERAL.—The term 'eligible employer' means, with respect to any year, an employer which had no more than 100 employees who received at least $5,000 of compensation from the employer for the preceding year.

"(ii) 2-YEAR GRACE PERIOD.—An eligible employer who establishes and maintains a plan under this subsection for 1 or more years and who fails to be an eligible employer for any subsequent year shall be treated as an eligible employer for the 2 years following the last year the employer was an eligible employer. If such failure is due to any acquisition, disposition, or simi-

lar transaction involving an eligible employer, the preceding sentence shall apply only in accordance with rules similar to the rules of section 410(b)(6)(C)(i).

"(B) EMPLOYEE.—The term 'employee' includes an employee as defined in section 401(c)(1).

"(C) ELIGIBLE EMPLOYEE.—

"(i) IN GENERAL.—The term 'eligible employee' means, with respect to any year, any employee who, prior to such year—

"(I) completed 2 consecutive years of service with the employer, and

"(II) attained 21 years of age.

A plan may provide a uniform shorter period of service or lower age to apply in lieu of those under the preceding sentence.

"(ii) EXCLUDABLE EMPLOYEES.—An employer may elect not to treat employees described in section 410(b)(3) as eligible employees.

"(iii) YEAR OF SERVICE.—For purposes of this paragraph, an employee shall be treated as completing a year of service

for each year for which the employee receives at least $5,000 of compensation from the employer.

"(D) COMPENSATION.—For purposes of this paragraph, the term 'compensation' means wages within the meaning of section 3401(a) and all other payments of compensation to an employee by the employer with respect to which the employer is required to furnish the employee a written statement under sections 6041(d), 6051(a)(3), and 6052. In the case of an employee (within the meaning of section 401(c)(1)), such term means earned income within the meaning of section 401(c)(2).

"(E) YEAR.—The term 'year' means the calendar year.

"(4) VESTING REQUIREMENTS.—A plan meets the requirements of this paragraph only if the employee's rights to the employee's account balance under the NEST are nonforfeitable. Except as provided in paragraph (5), the rules of subsection (k)(4) shall apply for purposes of this paragraph.

"(5) TWO-YEAR HOLDING PERIOD.—A plan meets the requirements of this paragraph only if the plan, and each NEST under the plan, prohibits the

withdrawal of contributions made for a year (and any earnings allocable thereto) during the 2-year period beginning on the first day of such year.

"(6) TIME CONTRIBUTIONS REQUIRED TO BE MADE.—

"(A) ELECTIVE CONTRIBUTIONS.—A plan meets the requirements of this paragraph only if, under the terms of the plan, the employer must make all elective contributions to a NEST not later than the date on which such contributions would otherwise be required to be made under title I of the Employee Retirement Income Security Act of 1974 if such contributions were elective contributions under a qualified cash or deferred arrangement under section 401(k).

"(B) NONELECTIVE AND MATCHING CONTRIBUTIONS.—

"(i) IN GENERAL.—A plan meets the requirements of this paragraph only if, under the terms of the plan, the employer must make all nonelective and matching contributions not later than the close of the 45-day period following the last day of

the calendar quarter for which the contributions are to be made.

"(ii) COMPENSATION EXCEPTION.—If an employer does not make nonelective contributions to a NEST for employees whose compensation from the employer for the year is less than the threshold amount of $5,000 (or such lower amount permitted under paragraph (2)(G)), then clause (i) shall apply with respect to nonelective contributions only for employees who received at least the threshold amount of compensation as of the end of the applicable quarter. In the case of an employee who reaches the threshold amount in a calendar quarter other than the first calendar quarter, the employer shall make nonelective contributions for that calendar quarter and all preceding calendar quarters not later than the date prescribed for that quarter.

"(C) CONTRIBUTIONS AFTER YEAR-END.—For purposes of this subsection, a contribution on account of a year which is made within 45 days (or within a period prescribed by the Secretary) after the close of the year shall be

deemed to have been made on the last day of such year.

"(7) EMPLOYEE ELECTIONS.—A plan meets the requirements of this paragraph only if, under the terms of the plan—

"(A) an employee may elect to terminate elective contributions (described in subparagraphs (B)(ii) and (C)(ii) of paragraph (2)) at any time during the year, except that, if the employer so elects, the employee may not resume participation until the first day of the next year (or such earlier time as provided by the plan), and

"(B) each employee eligible to participate—

"(i) may elect, during the 60-day period before the beginning of any year, to make elective contributions, or to modify the amount of elective contributions, for such year, and

"(ii) may elect, within 30 days of becoming eligible to participate in the plan, to make elective contributions for the year.

"(8) OTHER PLANS OF THE EMPLOYER.—

"(A) PROHIBITION ON OTHER PLANS WITH ELECTIVE OR MATCHING CONTRIBUTIONS.—A plan shall not meet the requirements of this paragraph for a year if the employer maintaining the plan maintains—

"(i) a plan providing for elective deferrals described in section 402(g)(3), or

"(ii) any plan described in section 401(a) which provides for matching contributions (within the meaning of section 401(m)(4)(A)).

For purposes of this subparagraph, an employer shall not be treated as maintaining a plan for a year if, under the plan, no contributions or benefit accruals may occur for such year.

"(B) COORDINATION WITH OTHER PLANS.—

"(i) OTHER PLANS DISREGARDED.—If an employer maintaining a plan to which this subsection applies also maintains 1 or more plans described in section 401(a), 403(a), or 408(k) (other than a plan described in subparagraph (A)), the determination of whether such plan satisfies the

requirements of this subsection shall be made without regard to such other plans.

"(ii) NEST DISREGARDED.—Except as provided in sections 404(m) and 415(a)(2), a plan to which this subsection applies shall not be taken into account in applying this title to any other plan described in clause (i).

"(9) EMPLOYER OPTIONS.—

"(A) USE OF DESIGNATED FINANCIAL INSTITUTION.—A plan shall not be treated as failing to satisfy the requirements of this subsection or any other provision of this title merely because the employer makes all contributions to the individual retirement accounts or annuities of a designated trustee or issuer. The preceding sentence shall not apply unless each NEST plan participant is notified in writing (either separately or as part of the notice under subsection (l)(2)(C)) that the participant's balance may be transferred without cost or penalty to another individual account or annuity in accordance with section 408(d)(3)(G).

"(B) SUSPENSION OF PLAN.—Except as provided by the Secretary, a plan shall not be

treated as failing to meet the requirements of this subsection if, under the plan, the employer may suspend all elective, matching, and nonelective contributions under the plan after notifying eligible employees of such suspension in writing at least 30 days in advance. Such suspension shall apply to contributions with respect to compensation earned after the effective date of the suspension. Only 1 suspension under this subparagraph may take effect during any year.

"(10) MODEL FORM TO BE PROVIDED.—The Secretary shall issue a model form that may be used by an eligible employer to establish a plan that satisfies all requirements of this subsection."

(b) TAX TREATMENT OF NESTS.—

(1) DEDUCTIBILITY OF CONTRIBUTIONS.—

(A) Section 219(b) (relating to maximum amount of deduction) is amended by adding at the end the following new paragraph:

"(4) SPECIAL RULE FOR NESTS.—This section shall not apply with respect to any amount contributed to a NEST established under section 408(p)."

(B) Section 219(g)(5)(A) (defining active participant) is amended by striking "or" at the

end of clause (iv) and by adding at the end the following new clause:

"(vi) any NEST (with the meaning of section 408(p)), or".

(C) Section 404 (relating to deductions for contributions of an employer) is amended by adding at the end the following new subsection:

"(m) SPECIAL RULES FOR NESTS.—

"(1) IN GENERAL.—Employer contributions to a NEST (within the meaning of section 408(p)) shall be treated as if they are made to a plan subject to the requirements of this section. Employer deductions for such contributions shall be subject to the following limitations:

"(A) Contributions made for a calendar year are deductible for the taxable year of the employer with or within which the calendar year ends.

"(B) Contributions shall be treated for purposes of this subsection as if they were made for a calendar year if such contributions are made on account of such calendar year and are made not later than the time prescribed in section 408(p)(6).

"(C) The amount deductible in a taxable year for a NEST shall not exceed the amount contributed pursuant to a qualified formula (within the meaning of section 408(p)(2)), and shall be deductible without regard to the amount contributed under any other plan subject to this section.

"(2) EFFECT ON STOCK BONUS AND PROFIT-SHARING TRUST.—For any taxable year for which the employer has a deduction under paragraph (1), the otherwise applicable limitations in subsection (a)(3)(A) with respect to a stock bonus or profit-sharing trust maintained by the same employer shall be reduced by the amount of the allowable deduction under paragraph (1).

"(3) COORDINATION WITH SUBSECTION (a)(7).—For purposes of applying the limitation of subsection (a)(7) with respect to a plan to which this section applies (other than a plan to which section 408(p) applies), a plan to which section 408(p) applies shall be treated as if it were a separate stock bonus or profit-sharing trust of the employer maintaining the plan.

"(4) COORDINATION WITH SUBSECTION (h).—For any taxable year for which the employer has a

deduction under paragraph (1), the otherwise applicable limitations in subsection (h) with respect to a simplified employee pension maintained by the same employer shall be reduced by the amount of the deduction allowable under paragraph (1)."

(2) CONTRIBUTIONS AND DISTRIBUTIONS.—

(A) Section 402 (relating to taxability of beneficiary of employees' trust) is amended by adding at the end the following new subsection:

"(k) TREATMENT OF NESTS.—The rules of paragraphs (1) and (3) of subsection (h) shall apply to contributions and distributions with respect to a NEST under section 408(p)."

(B) Section 408(d)(3) is amended by adding at the end the following new subparagraph:

"(G) NESTS.—This paragraph shall apply to an amount distributed to an individual with respect to a NEST only to the extent such amount is paid directly to an individual retirement account or annuity for the benefit of such individual in a direct transfer and, if applicable, such amount continues to be subject to the 2-year holding period described in subsection (p)(5)."

(C) Clause (i) of section 457(e)(2)(B) is amended by striking "section 402(h)(1)(B)" and inserting "section 402 (h)(1)(B) or (k)".

(c) REPORTING REQUIREMENTS.—

(1) IN GENERAL.—

(A) SUMMARY DESCRIPTIONS AND EMPLOYEE NOTIFICATION.—Section 408(l) is amended by adding at the end the following new paragraph:

"(2) NESTs.—

"(A) NO EMPLOYER REPORTS.—Except as provided in this paragraph, no report shall be required under this section by an employer maintaining a NEST under subsection (p).

"(B) SUMMARY DESCRIPTION.—The trustee or issuer of any individual retirement account or annuity under a NEST described in subsection (p) shall prepare, and provide to the employer maintaining the arrangement, each year a description containing the following information:

"(i) The name and address of the employer and the trustee or issuer.

"(ii) The requirements for eligibility for participation.

"(iii) The benefits provided with respect to the NEST.

"(iv) The time and method of making elections with respect to the NEST.

"(v) The procedures for, and effects of, distributions (including rollovers) from the arrangement.

"(C) EMPLOYEE NOTIFICATION.—The employer shall notify each employee immediately before the period for which an election described in subsection (p)(7)(B) may be made of the employee's opportunity to make such election. Such notice shall include a copy of the description described in subparagraph (B) and shall indicate whether matching contributions will be made with respect to the employee's elective contributions, and the level of employer matching and nonelective contributions which will be made, for the year for which the election may be made."

(B) CONFORMING AMENDMENT.—Section 408(l) is amended by striking "an employer" and inserting—

"(1) IN GENERAL.—An employer".

(2) TRUSTEE AND ISSUER REPORTS.—Section 408(i) (relating to reports of trustees or issuers) is amended by adding at the end thereof the following new flush sentence:

"In the case of an individual retirement account or annuity maintained in connection with a NEST described in subsection (p), only 1 report under this subsection shall be required to be submitted each calendar year to the Secretary (at the time provided under paragraph (2)) but, in addition to the report under this subsection, there shall be furnished, within 30 days after each calendar quarter, to the individual on whose behalf the account is maintained a statement with respect to the account balance as of the close of, and the account activity during, such calendar quarter."

(3) PENALTIES FOR FAILURE TO REPORT.—Section 6693 is amended by redesignating subsection (c) as subsection (d) and by inserting after subsection (b) the following new subsection:

"(c) PENALTIES RELATING TO NESTS.—

"(1) EMPLOYER PENALTIES.—An employer who fails to provide 1 or more notices required by section 408(l)(2)(C) shall pay a penalty of $50 for each day on which such failures continue.

"(2) TRUSTEE PENALTIES.—A trustee who fails—

"(A) to provide 1 or more statements required by the last sentence of section 408(i) shall pay a penalty of $50 for each day on which such failures continue, or

"(B) to provide 1 or more summary descriptions required by section 408(l)(2)(B) shall pay a penalty of $50 for each day on which such failures continue.

"(3) REASONABLE CAUSE EXCEPTION.—No penalty shall be imposed under this subsection with respect to any failure which the taxpayer shows was due to reasonable cause."

(d) CONFORMING AMENDMENTS.—

(1) Section 280G(b)(6) is amended by striking the "or" at the end of subparagraph (B), by striking the period at the end of subparagraph (C) and inserting ", or", and by adding after subparagraph (C) the following new subparagraph:

"(D) a NEST described in section 408(p)."

(2) Section 402(g)(3) is amended by striking "and" at the end of subparagraph (B), by striking the period at the end of subparagraph (C) and in-

serting ", and", and by adding after subparagraph (C) the following new subparagraph:

"(D) any elective contribution under section 408(p)(2)(B)(ii) or (C)(ii)."

(3) Subsections (b), (c), (m)(4)(B), and (n)(3)(B) of section 414 are each amended by inserting "408(p)," after "408(k),".

(4) Section 415(a)(2) is amended by adding at the end the following new flush sentence:

"A plan described in section 408(p) shall not be subject to this section, except that if an employer that maintains such plan also maintains 1 or more plans, annuities, or accounts subject to this section, such plan shall be taken into account in determining whether any such other plans, annuities, or accounts satisfy the requirements of this section."

(5) Section 4972(d)(1)(A) is amended by striking "and" at the end of clause (ii), by striking the period at the end of clause (iii) and inserting ", and", and by adding after clause (iii) the following new clause:

"(iv) any NEST (within the meaning of section 408(p))."

(6)(A) Paragraph (5) of section 3121(a) is amended by striking "or" at the end of subpara-

graph (F), by inserting "or" at the end of subparagraph (G), and by adding at the end the following new subparagraph:

"(H) under a plan to which section 408(p) applies, other than any elective contributions under subparagraphs (B)(ii) and (C)(ii) of section 408(p)(2),".

(B) Section 209(a)(4) of the Social Security Act is amended by inserting ", or (J) under a plan to which section 408(p) of such Code applies, other than any elective contributions under subparagraphs (B)(ii) and (C)(ii) of section 408(p)(2) of such Code" before the semicolon at the end thereof.

(C) Paragraph (5) of section 3306(b) is amended by striking "or" at the end of subparagraph (F), by inserting "or" at the end of subparagraph (G), and by adding at the end the following new subparagraph:

"(H) under a plan to which section 408(p) applies, other than any elective contributions under subparagraphs (B)(ii) and (C)(ii) of section 408(p)(2),".

(D) Paragraph (12) of section 3401(a) is amended by adding the following new subparagraph:

"(D) under or to a NEST described in section 408(p); or".

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to years beginning after December 31, 1996.

SEC. 1102. TAX-EXEMPT ORGANIZATIONS ELIGIBLE UNDER SECTION 401(k).

(a) IN GENERAL.—Subparagraph (B) of section 401(k)(4) is amended to read as follows:

"(B) ELIGIBILITY OF STATE AND LOCAL GOVERNMENTS AND TAX-EXEMPT ORGANIZATIONS.—

"(i) TAX-EXEMPTS ELIGIBLE.—Except as provided in clause (ii), any organization exempt from tax under this subtitle may include a qualified cash or deferred arrangement as part of a plan maintained by it.

"(ii) GOVERNMENTS INELIGIBLE.—A cash or deferred arrangement shall not be treated as a qualified cash or deferred arrangement if it is part of a plan maintained by a State or local government or political subdivision thereof, or any agency or instrumentality thereof. This clause

shall not apply to a rural cooperative plan or to a plan of an employer described in clause (iii).

"(iii) TREATMENT OF INDIAN TRIBAL GOVERNMENTS.—An employer which is an Indian tribal government (as defined in section 7701(a)(40)), a subdivision of an Indian tribal government (determined in accordance with section 7871(d)), or an agency or instrumentality of an Indian tribal government or subdivision thereof may include a qualified cash or deferred arrangement as part of a plan maintained by it."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to plan years beginning after December 31, 1996, but shall not apply to any cash or deferred arrangement to which clause (i) of section 1116(f)(2)(B) of the Tax Reform Act of 1986 applies.

SEC. 1103. NONDISCRIMINATION RULES FOR QUALIFIED CASH OR DEFERRED ARRANGEMENTS AND MATCHING CONTRIBUTIONS.

(a) ALTERNATIVE METHODS OF SATISFYING SECTION 401(k) NONDISCRIMINATION TESTS.—Section 401(k) (relating to cash or deferred arrangements) is

amended by adding at the end the following new paragraph:

"(11) ALTERNATIVE METHODS OF MEETING NONDISCRIMINATION REQUIREMENTS.—

"(A) IN GENERAL.—A cash or deferred arrangement shall be treated as meeting the requirements of paragraph (3)(A)(ii) if such arrangement—

"(i) meets the contribution requirements of subparagraph (B) or (C), and

"(ii) meets the notice requirements of subparagraph (D).

"(B) NONELECTIVE AND MATCHING CONTRIBUTIONS.—

"(i) IN GENERAL.—The requirements of this subparagraph are met if the requirements of clauses (ii) and (iii) are met.

"(ii) NONELECTIVE CONTRIBUTIONS.—The requirements of this clause are met if, under the arrangement, the employer is required, without regard to whether the employee makes an elective contribution or employee contribution, to make a contribution to a defined contribution plan on behalf of each employee who

is not a highly compensated employee and who is eligible to participate in the arrangement in an amount equal to at least 1 percent of the employee's compensation.

"(iii) MATCHING CONTRIBUTIONS.—The requirements of this clause are met if, under the arrangement, the employer makes matching contributions on behalf of each employee who is not a highly compensated employee in an amount equal to—

"(I) 100 percent of the elective contributions of the employee to the extent such elective contributions do not exceed 3 percent of the employee's compensation, and

"(II) 50 percent of the elective contributions of the employee to the extent that such elective contributions exceed 3 percent but do not exceed 5 percent of the employee's compensation.

"(iv) RATE FOR HIGHLY COMPENSATED EMPLOYEES.—The requirements of clause (iii) are not met if, under

the arrangement, the rate of matching contribution with respect to any rate of elective contribution of a highly compensated employee is greater than that with respect to an employee who is not a highly compensated employee. For purposes of this clause, to the extent provided in regulations, the last sentences of paragraph (3)(A) and subsection (m)(2)(B) shall not apply.

"(v) ALTERNATIVE PLAN DESIGNS.—If the rate of matching contribution with respect to any rate of elective contribution is not equal to the percentage required under clause (iii), an arrangement shall not be treated as failing to meet the requirements of clause (iii) if—

"(I) the rate of an employer's matching contribution does not increase as an employee's rate of elective contribution increase, and

"(II) the aggregate amount of matching contributions at such rate of elective contribution is at least equal to the aggregate amount of matching

contributions which would be made if matching contributions were made on the basis of the percentages described in clause (iii).

"(C) NONELECTIVE CONTRIBUTIONS.—The requirements of this subparagraph are met if, under the arrangement, the employer is required, without regard to whether the employee makes an elective contribution or employee contribution, to make a contribution to a defined contribution plan on behalf of each employee who is not a highly compensated employee and who is eligible to participate in the arrangement in an amount equal to at least 3 percent of the employee's compensation.

"(D) NOTICE REQUIREMENT.—An arrangement meets the requirements of this paragraph if, under the arrangement, each employee eligible to participate is, within a reasonable period before any year, given written notice of the employee's rights and obligations under the arrangement which—

"(i) is sufficiently accurate and comprehensive to reasonably apprise the employee of such rights and obligations, and

"(ii) is written in a manner calculated to be understood by the average employee eligible to participate.

"(E) OTHER REQUIREMENTS.—

"(i) WITHDRAWAL AND VESTING RESTRICTIONS.—An arrangement shall not be treated as meeting the requirements of subparagraph (B) or (C) of this paragraph unless the requirements of subparagraphs (B) and (C) of paragraph (2) are met with respect to all employer contributions (including matching contributions) taken into account in determining whether the requirements of subparagraphs (B) and (C) of this paragraph are met.

"(ii) SOCIAL SECURITY AND SIMILAR CONTRIBUTIONS NOT TAKEN INTO ACCOUNT.—An arrangement shall not be treated as meeting the requirements of subparagraph (B) or (C) unless such requirements are met without regard to subsection (l), and, for purposes of subsection (l), employer contributions under subparagraph (B) or (C) shall not be taken into account.

"(F) OTHER PLANS.—An arrangement shall be treated as meeting the requirements under subparagraph (A)(i) if any other plan maintained by the employer meets such requirements with respect to employees eligible under the arrangement."

(b) ALTERNATIVE METHODS OF SATISFYING SECTION 401(m) NONDISCRIMINATION TESTS.—Section 401(m) (relating to nondiscrimination test for matching contributions and employee contributions) is amended by redesignating paragraph (10) as paragraph (11) and by adding after paragraph (9) the following new paragraph:

"(10) ALTERNATIVE METHOD OF SATISFYING TESTS.—

"(A) IN GENERAL.—A defined contribution plan shall be treated as meeting the requirements of paragraph (2) with respect to matching contributions if the plan—

"(i) meets the contribution requirements of subparagraph (B) or (C) of subsection (k)(11),

"(ii) meets the notice requirements of subsection (k)(11)(D), and

"(iii) meets the requirements of subparagraphs (B) and (C).

"(B) LIMITATION ON MATCHING CONTRIBUTIONS.—The requirements of this subparagraph are met if—

"(i) matching contributions on behalf of any employee may not be made with respect to an employee's contributions or elective deferrals in excess of 6 percent of the employee's compensation,

"(ii) the rate of an employer's matching contribution does not increase as the rate of an employee's contributions or elective deferrals increase, and

"(iii) the matching contribution with respect to any highly compensated employee at any rate of an employee contribution or rate of elective deferral is not greater than that with respect to an employee who is not a highly compensated employee.

To the extent provided in regulations, the last sentences of paragraph (2)(B) and subsection (k)(3)(A) shall not apply for purposes of clause (iii).

"(C) TEST MUST BE MET SEPARATELY.—If this paragraph applies to any matching con-

tributions, such contributions shall not be taken into account in determining whether employee contributions satisfy the requirements of this subsection."

(c) YEAR FOR COMPUTING NONHIGHLY COMPENSATED EMPLOYEE PERCENTAGE.—

(1) CASH OR DEFERRED ARRANGEMENTS.—Clause (ii) of section 401(k)(3)(A) is amended—

(A) by striking "such year" and inserting "the plan year",

(B) by striking "for such plan year" and inserting "for the preceding plan year", and

(C) by adding at the end the following new sentence: "An arrangement may apply this clause by using the plan year rather than the preceding plan year if the employer so elects, except that if such an election is made, it may not be changed except as provided by the Secretary."

(2) MATCHING AND EMPLOYEE CONTRIBUTIONS.—Section 401(m)(2)(A) is amended—

(A) by inserting "for such plan year" after "highly compensated employees",

(B) by inserting "for the preceding plan year" after "eligible employees" each place it appears in clause (i) and clause (ii), and

(C) by adding at the end the following flush sentence: "This subparagraph may be applied by using the plan year rather than the preceding plan year if the employer so elects, except that if such an election is made, it may not be changed except as provided the Secretary."

(d) SPECIAL RULE FOR DETERMINING AVERAGE DEFERRAL PERCENTAGE FOR FIRST PLAN YEAR, ETC.—

(1) Paragraph (3) of section 401(k) is amended by adding at the end the following new subparagraph:

"(E) For purposes of this paragraph, in the case of the first plan year of any plan, the amount taken into account as the actual deferral percentage of nonhighly compensated employees for the preceding plan year shall be—

"(i) 3 percent, or

"(ii) the actual deferral percentage of nonhighly compensated employees determined for such first plan year in the case of—

"(I) an employer who elects to have this clause apply, or

"(II) except to the extent provided by the Secretary, a successor plan."

(2) Paragraph (3) of section 401(m) is amended by adding at the end the following: "Rules similar to the rules of subsection (k)(3)(E) shall apply for purposes of this subsection."

(e) DISTRIBUTION OF EXCESS CONTRIBUTIONS AND EXCESS AGGREGATE CONTRIBUTIONS.—

(1) Subparagraph (C) of section 401(k)(8) (relating to arrangement not disqualified if excess contributions distributed) is amended by striking "on the basis of the respective portions of the excess contributions attributable to each of such employees" and inserting "on the basis of the amount of contributions by, or on behalf of, each of such employees".

(2) Subparagraph (C) of section 401(m)(6) (relating to method of distributing excess aggregate contributions) is amended by striking "on the basis of the respective portions of such amounts attributable to each of such employees" and inserting "on

the basis of the amount of contributions on behalf of, or by, each such employee".

(f) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by this section shall apply to plan years beginning after December 31, 1998.

(2) SUBSECTIONS (c), (d), AND (e).—The amendments made by subsections (c), (d), and (e) shall apply to plan years beginning after December 31, 1996.

SEC. 1104. REPEAL OF FAMILY AGGREGATION.

(a) REPEAL OF FAMILY AGGREGATION RULES.—

(1) IN GENERAL.—Paragraph (6) of section 414(q) is hereby repealed.

(2) COMPENSATION LIMIT.—Paragraph (17)(A) of section 401(a) is amended by striking the last sentence.

(3) DEDUCTION.—Subsection (l) of section 404 is amended by striking the last sentence.

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to years beginning after December 31, 1996.

SEC. 1105. DEFINITION OF HIGHLY COMPENSATED EMPLOYEES.

(a) IN GENERAL.—Paragraph (1) of section 414(q) (defining highly compensated employee) is amended to read as follows:

"(1) IN GENERAL.—The term 'highly compensated employee' means any employee who—

"(A) was a 5-percent owner at any time during the year or the preceding year, or

"(B) for the preceding year had compensation from the employer in excess of $80,000.

The Secretary shall adjust the $80,000 amount under subparagraph (B) at the same time and in the same manner as under section 415(d), except that the base period shall be the calendar quarter ending September 30, 1996."

(b) CONFORMING AMENDMENTS.—

(1)(A) Subsection (q) of section 414 is amended by striking paragraphs (2), (4), (5), (8), (10), and (12) and by redesignating paragraphs (3), (7), (9), and (11) as paragraphs (2) through (5), respectively.

(B) Sections 129(d)(8)(B), 401(a)(5)(D)(ii), 408(k)(2)(C), and 416(i)(1)(D) are each amended by striking "section 414(q)(7)" and inserting "section 414(q)(3)".

(C) Section 416(i)(1)(A) is amended by striking "section 414(q)(8)" and inserting "section 414(r)(9)".

(2)(A) Section 414(r) is amended by adding at the end the following new paragraph:

"(9) EXCLUDED EMPLOYEES.—For purposes of paragraph (2)(A), the following employees shall be excluded:

"(A) Employees who have not completed 6 months of service.

"(B) Employees who normally work less than 17½ hours per week.

"(C) Employees who normally work not more than 6 months during any year.

"(D) Employees who have not attained the age of 21.

"(E) Except to the extent provided in regulations, employees who are included in a unit of employees covered by an agreement which the Secretary of Labor finds to be a collective bargaining agreement between employee representatives and the employer."

(B) Subparagraph (A) of section 414(r)(2) is amended by striking "subsection (q)(8)" and inserting "paragraph (9)".

(3) Section 1114(c)(4) of the Tax Reform Act of 1986 is amended by adding at the end the following new sentence: "Any reference in this paragraph to section 414(q) shall be treated as a reference to such section as in effect on the day before the date of the enactment of the Retirement Savings and Security Act.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to years beginning after December 31, 1996, except that in determining whether an employee is a highly compensated employee for years beginning in 1997, such amendments shall be treated as having been in effect for years beginning in 1996.

SEC. 1106. REPEAL OF LIMITATION IN CASE OF DEFINED BENEFIT PLAN AND DEFINED CONTRIBUTION PLAN FOR SAME EMPLOYEE.

(a) IN GENERAL.—Section 415(e) is repealed.

(b) CONFORMING AMENDMENTS.—

(1) Paragraph (1) of section 415(a) is amended—

(A) by adding "or" at the end of subparagraph (A),

(B) by striking ", or" at the end of subparagraph (B) and inserting a period, and

(C) by striking subparagraph (C).

(2) Subparagraph (B) of section 415(b)(5) is amended by striking "and subsection (e)".

(3) Paragraph (1) of section 415(f) is amended by striking "subsections (b), (c), and (e)" and inserting "subsections (b) and (c)".

(4) Subsection (g) of section 415 is amended by striking "subsections (e) and (f)" in the last sentence and inserting "subsection (f)".

(5) Clause (i) of section 415(k)(2)(A) is amended to read as follows:

"(i) any contribution made directly by an employee under such an arrangement shall not be treated as an annual addition for purposes of subsection (c), and".

(6) Clause (ii) of section 415(k)(2)(A) is amended by striking "subsections (c) and (e)" and inserting "subsection (c)".

(7) Section 416 is amended by striking subsection (h).

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to years beginning after December 31, 1998.

SEC. 1107. CONTRIBUTIONS ON BEHALF OF DISABLED EMPLOYEES.

(a) ALL DISABLED PARTICIPANTS RECEIVING CONTRIBUTIONS.—Section 415(c)(3)(C) is amended by adding at the end the following: "If a defined contribution plan provides for the continuation of contributions on behalf of all participants described in clause (i) for a fixed or determinable period. this subparagraph shall be applied without regard to clauses (ii) and (iii)."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to years beginning after December 31. 1996.

SEC. 1108. PLANS COVERING SELF-EMPLOYED INDIVIDUALS.

(a) AGGREGATION RULES.—Section 401(d) (relating to additional requirements for qualification of trusts and plans benefiting owner-employees) is amended to read as follows:

"(d) CONTRIBUTION LIMIT ON OWNER-EMPLOYEES.—A trust forming part of a pension or profit-sharing plan which provides contributions or benefits for employees some or all of whom are owner-employees shall constitute a qualified trust under this section only if, in addition to meeting the requirements of subsection (a), the plan provides that contributions on behalf of any owner-employee may be made only with respect to the earned

income of such owner-employee which is derived from the trade or business with respect to which such plan is established."

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to plan years beginning after December 31, 1996.

SEC. 1109. TRUST REQUIREMENT FOR DEFERRED COMPENSATION PLANS OF STATE AND LOCAL GOVERNMENTS.

(a) IN GENERAL.—Section 457 is amended by adding at the end the following new subsection:

"(g) GOVERNMENTAL PLANS MUST MAINTAIN SET-ASIDES FOR EXCLUSIVE BENEFIT OF PARTICIPANTS.—

"(1) IN GENERAL.—A plan maintained by an eligible employer described in subsection (e)(1)(A) shall not be treated as an eligible deferred compensation plan unless all amounts, property and rights, and income of the plan described in subparagraphs (A), (B), and (C) of subsection (b)(6) are held in trust for the exclusive benefit of participants and their beneficiaries.

"(2) TAXABILITY OF TRUSTS AND PARTICIPANTS.—For purposes of this title—

"(A) a trust described in paragraph (1) shall be treated as an organization exempt from taxation under section 501(a), and

"(B) notwithstanding any other provision of this title, amounts in the trust shall be includible in the gross income of participants and beneficiaries only to the extent, and at the time, provided in this section.

"(3) CUSTODIAL ACCOUNT AND CONTRACTS.—For purposes of this subsection, custodial accounts and contracts described in section 401(f) shall be treated as trusts under rules similar to the rules under section 401(f)."

(b) CONFORMING AMENDMENT.—Paragraph (6) of section 457(b) is amended by inserting "except as provided in subsection (g)," before "which provides that".

(c) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to amounts, property and rights, and income described in subparagraphs (A), (B), and (C) of section 457(b)(6) of the Internal Revenue Code of 1986 held by a plan on and after the date of the enactment of this Act.

(2) TRANSITION RULE.—In the case of amounts, property and rights, and income described in paragraph (1) under a plan before the last day of the first calendar quarter beginning after the close of the first regular session (beginning after the date of the enactment of this Act) of the State legislature of the State in which the governmental entity maintaining the plan is located, a trust need not be established by reason of the amendments made by this section before such last day. For purposes of the preceding sentence, in the case of a State that has a 2-year legislative session, each year of such session shall be deemed to be a separate regular session of the State legislature.

CHAPTER 2—SIMPLIFICATION AND COST SAVINGS

SEC. 1201. TREATMENT OF GOVERNMENTAL AND MULTIEMPLOYER PLANS UNDER SECTION 415 AND TREATMENT OF EXCESS BENEFIT PLANS.

(a) COMPENSATION LIMIT.—Subsection (b) of section 415 is amended by adding immediately after paragraph (10) the following new paragraph:

"(11) SPECIAL LIMITATION RULE FOR GOVERNMENTAL AND MULTIEMPLOYER PLANS.—In the case of a governmental plan (as defined in section

414(d)) or a multiemployer plan (as defined in section 414(f)), subparagraph (B) of paragraph (1) shall not apply."

(b) TREATMENT OF CERTAIN EXCESS BENEFIT PLANS.—

(1) IN GENERAL.—Section 415 is amended by adding at the end the following new subsection:

"(m) TREATMENT OF QUALIFIED GOVERNMENTAL EXCESS BENEFIT ARRANGEMENTS.—

"(1) GOVERNMENTAL PLAN NOT AFFECTED.—In determining whether a governmental plan (as defined in section 414(d)) meets the requirements of this section, benefits provided under a qualified governmental excess benefit arrangement shall not be taken into account. Income accruing to a governmental plan (or to a trust that is maintained solely for the purpose of providing benefits under a qualified governmental excess benefit arrangement) in respect of a qualified governmental excess benefit arrangement shall constitute income derived from the exercise of an essential governmental function upon which such governmental plan (or trust) shall be exempt from tax under section 115.

"(2) TAXATION OF PARTICIPANT.—For purposes of this chapter—

"(A) the taxable year or years for which amounts in respect of a qualified governmental excess benefit arrangement are includible in gross income by a participant, and

"(B) the treatment of such amounts when so includible by the participant,

shall be determined as if such qualified governmental excess benefit arrangement were treated as a plan for the deferral of compensation which is maintained by a corporation not exempt from tax under this chapter and which does not meet the requirements for qualification under section 401.

"(3) QUALIFIED GOVERNMENTAL EXCESS BENEFIT ARRANGEMENT.—For purposes of this subsection, the term 'qualified governmental excess benefit arrangement' means a portion of a governmental plan if—

"(A) such portion is maintained solely for the purpose of providing to participants in the plan that part of the participant's annual benefit otherwise payable under the terms of the plan that exceeds the limitations on benefits imposed by this section,

"(B) under such portion no election is provided at any time to the participant (directly or indirectly) to defer compensation. and

"(C) benefits described in subparagraph (A) are not paid from a trust forming a part of such governmental plan unless such trust is maintained solely for the purpose of providing such benefits."

(2) RULES RELATING TO EXCESS BENEFIT ARRANGEMENT.—

(A) APPLICATION OF SECTION 457.—Subsection (e) of section 457 is amended by adding at the end the following new paragraph:

"(14) TREATMENT OF EXCESS BENEFIT ARRANGEMENTS.—

"(A) IN GENERAL.—Subsections (b)(2) and (e)(1) shall not apply to any excess benefit arrangement and benefits provided under such an arrangement shall not be taken into account in determining whether any other plan is an eligible deferred compensation plan.

"(B) EXCESS BENEFIT ARRANGEMENT DEFINED.—For purposes of this section, the term excess benefit arrangement' means a plan which is maintained by an eligible employer

solely for purposes of providing benefits for certain employees in excess of the limits on contributions and benefits imposed by section 415. Such term includes a qualified governmental excess benefit arrangement (as defined in section 415(m)(3))."

(B) CONFORMING AMENDMENT.—Paragraph (2) of section 457(f) is amended by striking "and" at the end of subparagraph (C), by striking the period at the end of subparagraph (D) and inserting ", and", and by inserting immediately thereafter the following new subparagraph:

"(E) an excess benefit arrangement (as defined in subsection (e)(14)(B))."

(c) EXEMPTION FOR SURVIVOR AND DISABILITY BENEFITS.—Paragraph (2) of section 415(b) is amended by adding at the end the following new subparagraph:

"(I) EXEMPTION FOR SURVIVOR AND DISABILITY BENEFITS PROVIDED UNDER GOVERNMENTAL AND MULTIEMPLOYER PLANS.—Subparagraph (C) of this paragraph and paragraph (5) shall not apply to—

"(i) income received from a governmental plan (as defined in section 414(d))

or a multiemployer plan (as defined in section 414(f)) as a pension, annuity, or similar allowance as the result of the recipient becoming disabled by reason of personal injuries or sickness, or

"(ii) amounts received from a governmental or multiemployer plan by the beneficiaries, survivors, or the estate of an employee as the result of the death of the employee."

(d) REVOCATION OF GRANDFATHER ELECTION.—

(1) IN GENERAL.—Subparagraph (C) of section 415(b)(10) is amended by adding at the end the following new clause:

"(ii) REVOCATION OF ELECTION.—An election under clause (i) may be revoked not later than the last day of the third plan year beginning after the date of the enactment of this clause. The revocation shall apply to all plan years to which the election applied and to all subsequent plan years. Any amount paid by a plan in a taxable year ending after the revocation shall be includible in income in such taxable year under the rules of this chapter in ef-

fect for such taxable year, except that, for purposes of applying the limitations imposed by this section, any portion of such amount which is attributable to any taxable year during which the election was in effect shall be treated as received in such taxable year."

(2) CONFORMING AMENDMENT.—Subparagraph (C) of section 415(b)(10) is amended by striking "This" and inserting:

"(i) IN GENERAL.—This".

(e) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by subsections (a), (b), and (c) shall apply to years beginning after December 31, 1996.

(2) SPECIAL RULES FOR GOVERNMENTAL PLANS.—

(A) IN GENERAL.—In the case of a governmental plan, the amendments made by subsections (a), (b), and (c) shall apply to years beginning after December 31, 1995.

(B) REVOCATIONS.—The amendments made by subsection (d) shall apply with respect to revocations adopted after the date of the enactment of this Act.

(C) TREATMENT FOR YEARS BEGINNING BEFORE JANUARY 1, 1996.—Nothing in the amendments made by this section shall be construed to imply that a governmental plan (as defined in section 414(d) of the Internal Revenue Code of 1986) fails to satisfy the requirements of section 415 of such Code for any year beginning before January 1, 1996.

SEC. 1202. DEFINITION OF COMPENSATION FOR SECTION 415 PURPOSES.

(a) GENERAL RULE.—Section 415(c)(3) (defining participant's compensation) is amended by adding at the end the following new subparagraph:

"(D) CERTAIN DEFERRALS INCLUDED.—The term 'participant's compensation' shall include—

"(i) any elective deferral (as defined in section 402(g)(3)),

"(ii) any amount which is contributed by the employer at the election of the employee and which is not includible in the gross income of the employee pursuant to section 125, and

"(iii) any amount which is deferred at the election of the employee and which is

not includible in the gross income of the employee pursuant to section 457."

(b) CONFORMING AMENDMENTS.—

(1) Section 414(q)(3), as redesignated by section 1105, is amended to read as follows:

"(3) COMPENSATION.—For purposes of this subsection, the term 'compensation' has the meaning given such term by section 415(c)(3)."

(2) Section 414(s)(2) is amended by inserting "not" after "elect" in the text and heading thereof.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to years beginning after December 31, 1996.

SEC. 1203. ASSUMPTIONS FOR ADJUSTING CERTAIN BENEFITS OF DEFINED BENEFIT PLANS FOR EARLY RETIREES.

(a) IN GENERAL.—Subparagraph (E) of section 415(b)(2) (relating to limitation on certain assumptions) is amended—

(1) by striking "Except as provided in clause (ii), for purposes of adjusting any benefit or limitation under subparagraph (B) or (C)," in clause (i) and inserting "For purposes of adjusting any limitation under subparagraph (C) and, except as provided

in clause (ii), for purposes of adjusting any benefit under subparagraph (B).", and

(2) by striking "For purposes of adjusting the benefit or limitation of any form of benefit subject to section 417(e)(3)," in clause (ii) and inserting "For purposes of adjusting any benefit under subparagraph (B) for any form of benefit subject to section 417(e)(3),".

(b) EFFECTIVE DATE.—The amendments made by this section shall take effect as if included in the provisions of section 767 of the Uruguay Round Agreements Act.

SEC. 1204. TREATMENT OF DEFERRED COMPENSATION PLANS OF STATE AND LOCAL GOVERNMENTS AND TAX-EXEMPT ORGANIZATIONS.

(a) SPECIAL RULES FOR PLAN DISTRIBUTIONS.—Paragraph (9) of section 457(e) (relating to other definitions and special rules) is amended to read as follows:

"(9) BENEFITS NOT TREATED AS MADE AVAILABLE BY REASON OF CERTAIN ELECTIONS, ETC.—

"(A) TOTAL AMOUNT PAYABLE IS $3,500 OR LESS.—The total amount payable to a participant under the plan shall not be treated as made available merely because the participant may elect to receive such amount (or the plan

may distribute such amount without the participant's consent) if—

"(i) such amount does not exceed $3,500, and

"(ii) such amount may be distributed only if—

"(I) no amount has been deferred under the plan with respect to such participant during the 2-year period ending on the date of the distribution, and

"(II) there has been no prior distribution under the plan to such participant to which this subparagraph applied.

A plan shall not be treated as failing to meet the distribution requirements of subsection (d) by reason of a distribution to which this subparagraph applies.

"(B) ELECTION TO DEFER COMMENCEMENT OF DISTRIBUTIONS.—The total amount payable to a participant under the plan shall not be treated as made available merely because the participant may elect to defer commencement of distributions under the plan if—

"(i) such election is made after amounts may be available under the plan in accordance with subsection (d)(1)(A) and before commencement of such distributions, and

"(ii) the participant may make only 1 such election."

(b) COST-OF-LIVING ADJUSTMENT OF MAXIMUM DEFERRAL AMOUNT.—Subsection (e) of section 457, as amended by section 1201(b)(2) (relating to governmental plans), is amended by adding at the end the following new paragraph:

"(15) COST-OF-LIVING ADJUSTMENT OF MAXIMUM DEFERRAL AMOUNT.—The Secretary shall adjust the $7,500 amount specified in subsections (b)(2) and (c)(1) at the same time and in the same manner as under section 415(d), except that the base period shall be the calendar quarter ending September 30, 1994, and any increase under this paragraph which is not a multiple of $500 shall be rounded to the next lowest multiple of $500."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1996.

SEC. 1205. NO REQUIRED DISTRIBUTIONS FOR ACTIVE EMPLOYEES.

(a) IN GENERAL.—Section 401(a)(9)(C) (defining required beginning date) is amended to read as follows:

"(C) REQUIRED BEGINNING DATE.—For purposes of this paragraph—

"(i) IN GENERAL.—The term 'required beginning date' means April 1 of the calendar year following the later of—

"(I) the calendar year in which the employee attains age 70½, or

"(II) the calendar year in which the employee retires.

"(ii) EXCEPTION.—Subclause (II) of clause (i) shall not apply—

"(I) except as provided in section 409(d), in the case of an employee who is a 5-percent owner (as defined in section 416) with respect to the plan year ending in the calendar year in which the employee attains age 70½, or

"(II) for purposes of section 408 (a)(6) or (b)(3).

"(iii) ACTUARIAL ADJUSTMENT.—In the case of an employee to whom clause

(i)(II) applies who retires in a calendar year after the calendar year in which the employee attains age 70½, the employee's accrued benefit shall be actuarially increased to take into account the period after age 70½ in which the employee was not receiving any benefits under the plan.

"(iv) EXCEPTION FOR GOVERNMENTAL AND CHURCH PLANS.—Clauses (ii) and (iii) shall not apply in the case of a governmental plan or church plan. For purposes of this clause, the term 'church plan' means a plan maintained by a church for church employees, and the term 'church' means any church (as defined in section 3121(w)(3)(A)) or qualified church-controlled organization (as defined in section 3121(w)(3)(B))."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to years beginning after December 31, 1996.

SEC. 1206. SIMPLIFIED METHOD FOR TAXING ANNUITY DISTRIBUTIONS UNDER CERTAIN EMPLOYER PLANS.

(a) GENERAL RULE.—Subsection (d) of section 72 (relating to annuities; certain proceeds of endowment and life insurance contracts) is amended to read as follows:

"(d) SPECIAL RULES FOR QUALIFIED EMPLOYER RETIREMENT PLANS.—

"(1) SIMPLIFIED METHOD OF TAXING ANNUITY PAYMENTS.—

"(A) IN GENERAL.—In the case of any amount received as an annuity under a qualified employer retirement plan—

"(i) subsection (b) shall not apply, and

"(ii) the investment in the contract shall be recovered as provided in this paragraph.

"(B) METHOD OF RECOVERING INVESTMENT IN CONTRACT.—

"(i) IN GENERAL.—Gross income shall not include so much of any monthly annuity payment under a qualified employer retirement plan as does not exceed the amount obtained by dividing—

"(I) the investment in the contract (as of the annuity starting date), by

"(II) the number of anticipated payments determined under the table contained in clause (iii) (or, in the case of a contract to which subsection (c)(3)(B) applies, the number of monthly annuity payments under such contract).

"(ii) CERTAIN RULES MADE APPLICABLE.—Rules similar to the rules of paragraphs (2) and (3) of subsection (b) shall apply for purposes of this paragraph.

"(iii) NUMBER OF ANTICIPATED PAYMENTS.—

"If the age of the primary annuitant on the annuity starting date is:	The number of anticipated payments is:
Not more than 55	360
More than 55 but not more than 60	310
More than 60 but not more than 65	260
More than 65 but not more than 70	210
More than 70	160.

"(C) ADJUSTMENT FOR REFUND FEATURE NOT APPLICABLE.—For purposes of this paragraph, investment in the contract shall be de-

termined under subsection (c)(1) without regard to subsection (c)(2).

"(D) SPECIAL RULE WHERE LUMP SUM PAID IN CONNECTION WITH COMMENCEMENT OF ANNUITY PAYMENTS.—If, in connection with the commencement of annuity payments under any qualified employer retirement plan, the taxpayer receives a lump sum payment—

"(i) such payment shall be taxable under subsection (e) as if received before the annuity starting date, and

"(ii) the investment in the contract for purposes of this paragraph shall be determined as if such payment had been so received.

"(E) EXCEPTION.—This paragraph shall not apply in any case where the primary annuitant has attained age 75 on the annuity starting date unless there are fewer than 5 years of guaranteed payments under the annuity.

"(F) ADJUSTMENT WHERE ANNUITY PAYMENTS NOT ON MONTHLY BASIS.—In any case where the annuity payments are not made on a monthly basis, appropriate adjustments in the application of this paragraph shall be made to

take into account the period on the basis of which such payments are made.

"(G) QUALIFIED EMPLOYER RETIREMENT PLAN.—For purposes of this paragraph, the term 'qualified employer retirement plan' means any plan or contract described in paragraph (1), (2), or (3) of section 4974(c).

"(2) TREATMENT OF EMPLOYEE CONTRIBUTIONS UNDER DEFINED CONTRIBUTION PLANS.—For purposes of this section, employee contributions (and any income allocable thereto) under a defined contribution plan may be treated as a separate contract."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply in cases where the annuity starting date is after December 31, 1996.

SEC. 1207. REPEAL OF 5-YEAR INCOME AVERAGING FOR LUMP-SUM DISTRIBUTIONS.

(a) IN GENERAL.—Subsection (d) of section 402 (relating to taxability of beneficiary of employees' trust) is amended to read as follows:

"(d) TAXABILITY OF BENEFICIARY OF CERTAIN FOREIGN SITUS TRUSTS.—For purposes of subsections (a), (b), and (c), a stock bonus, pension, or profit-sharing trust which would qualify for exemption from tax under

section 501(a) except for the fact that it is a trust created or organized outside the United States shall be treated as if it were a trust exempt from tax under section 501(a)."

(b) CONFORMING AMENDMENTS.—

(1) Subparagraph (D) of section 402(e)(4) (relating to other rules applicable to exempt trusts) is amended to read as follows:

"(D) LUMP-SUM DISTRIBUTION.—For purposes of this paragraph—

"(i) IN GENERAL.—The term 'lump sum distribution' means the distribution or payment within one taxable year of the recipient of the balance to the credit of an employee which becomes payable to the recipient—

"(I) on account of the employee's death,

"(II) after the employee attains age 59½,

"(III) on account of the employee's separation from service, or

"(IV) after the employee has become disabled (within the meaning of section 72(m)(7)),

from a trust which forms a part of a plan described in section 401(a) and which is exempt from tax under section 501 or from a plan described in section 403(a). Subclause (III) of this clause shall be applied only with respect to an individual who is an employee without regard to section 401(c)(1), and subclause (IV) shall be applied only with respect to an employee within the meaning of section 401(c)(1). For purposes of this clause, a distribution to two or more trusts shall be treated as a distribution to one recipient. For purposes of this paragraph, the balance to the credit of the employee does not include the accumulated deductible employee contributions under the plan (within the meaning of section 72(o)(5)).

"(ii) AGGREGATION OF CERTAIN TRUSTS AND PLANS.—For purposes of determining the balance to the credit of an employee under clause (i)—

"(I) all trusts which are part of a plan shall be treated as a single trust, all pension plans maintained by

the employer shall be treated as a single plan, all profit-sharing plans maintained by the employer shall be treated as a single plan, and all stock bonus plans maintained by the employer shall be treated as a single plan, and

"(II) trusts which are not qualified trusts under section 401(a) and annuity contracts which do not satisfy the requirements of section 404(a)(2) shall not be taken into account.

"(iii) COMMUNITY PROPERTY LAWS.—The provisions of this paragraph shall be applied without regard to community property laws.

"(iv) AMOUNTS SUBJECT TO PENALTY.—This paragraph shall not apply to amounts described in subparagraph (A) of section 72(m)(5) to the extent that section 72(m)(5) applies to such amounts.

"(v) BALANCE TO CREDIT OF EMPLOYEE NOT TO INCLUDE AMOUNTS PAYABLE UNDER QUALIFIED DOMESTIC RELATIONS ORDER.—For purposes of this para-

graph, the balance to the credit of an employee shall not include any amount payable to an alternate payee under a qualified domestic relations order (within the meaning of section 414(p)).

"(vi) TRANSFERS TO COST-OF-LIVING ARRANGEMENT NOT TREATED AS DISTRIBUTION.—For purposes of this paragraph, the balance to the credit of an employee under a defined contribution plan shall not include any amount transferred from such defined contribution plan to a qualified cost-of-living arrangement (within the meaning of section 415(k)(2)) under a defined benefit plan.

"(vii) LUMP-SUM DISTRIBUTIONS OF ALTERNATE PAYEES.—If any distribution or payment of the balance to the credit of an employee would be treated as a lump-sum distribution, then, for purposes of this paragraph, the payment under a qualified domestic relations order (within the meaning of section 414(p)) of the balance to the credit of an alternate payee who is the spouse or former spouse of the employee

shall be treated as a lump-sum distribution. For purposes of this clause, the balance to the credit of the alternate payee shall not include any amount payable to the employee."

(2) Section 402(c) (relating to rules applicable to rollovers from exempt trusts) is amended by striking paragraph (10).

(3) Paragraph (1) of section 55(c) (defining regular tax) is amended by striking "shall not include any tax imposed by section 402(d) and".

(4) Paragraph (8) of section 62(a) (relating to certain portion of lump-sum distributions from pension plans taxed under section 402(d)) is hereby repealed.

(5) Section 401(a)(28)(B) (relating to coordination with distribution rules) is amended by striking clause (v).

(6) Subparagraph (B)(ii) of section 401(k)(10) (relating to distributions that must be lump-sum distributions) is amended to read as follows:

"(ii) LUMP-SUM DISTRIBUTION.—For purposes of this subparagraph, the term 'lump-sum distribution' has the meaning given such term by section 402(e)(4)(D),

without regard to subclauses (I), (II), (III), and (IV) of clause (i) thereof."

(7) Section 406(c) (relating to termination of status as deemed employee not to be treated as separation from service for purposes of limitation of tax) is hereby repealed.

(8) Section 407(c) (relating to termination of status as deemed employee not to be treated as separation from service for purposes of limitation of tax) is hereby repealed.

(9) Section 691(c) (relating to deduction for estate tax) is amended by striking paragraph (5).

(10) Paragraph (1) of section 871(b) (relating to imposition of tax) is amended by striking "section 1, 55, or 402(d)(1)" and inserting "section 1 or 55".

(11) Subsection (b) of section 877 (relating to alternative tax) is amended by striking "section 1, 55, or 402(d)(1)" and inserting "section 1 or 55".

(12) Section 4980A(c)(4) is amended—

(A) by striking "to which an election under section 402(d)(4)(B) applies" and inserting "(as defined in section 402(e)(4)(D)) with respect to which the individual elects to have this paragraph apply",

(B) by adding at the end the following new flush sentence:

"An individual may elect to have this paragraph apply to only one lump-sum distribution.", and

(C) by striking the heading and inserting:

"(4) SPECIAL ONE-TIME ELECTION.—".

(13) Section 402(e) is amended by striking paragraph (5).

(c) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by this section shall apply to taxable years beginning after December 31, 1998.

(2) RETENTION OF CERTAIN TRANSITION RULES.—Notwithstanding any other provision of this section, the amendments made by this section shall not apply to any distribution for which the taxpayer elects the benefits of section 1122 (h)(3) or (h)(5) of the Tax Reform Act of 1986. For purposes of the preceding sentence, the rules of sections 402(c)(10) and 402(d) of the Internal Revenue Code of 1986 (as in effect before the amendments made by this Act) shall apply.

SEC. 1208. ELIMINATION OF HALF-YEAR REQUIREMENTS.

(a) IN GENERAL.—Each of the following provisions are amended by striking "age 59½" and inserting "age 59":

(1) Section 72(q)(2)(A).

(2) Section 72(q)(3)(B)(i).

(3) Section 72(q)(3)(B)(ii).

(4) Section 72(t)(2)(A)(i).

(5) Section 72(t)(4)(A)(ii)(I).

(6) Section 72(t)(4)(A)(ii)(II).

(7) Section 72(v)(2)(A).

(8) Section 401(k)(2)(B)(i)(III).

(9) Section 403(b)(7)(A)(ii).

(10) Section 403(b)(11)(A).

(11) The heading for section 403(b)(11).

(12) Section 4978(d)(1)(B).

(b) OTHER PROVISIONS.—Each of the following provisions are amended by striking "age 70½" each place it appears and inserting "age 70":

(1) Section 219(d)(1).

(2) The heading for section 219(d)(1).

(3) Section 401(a)(9)(B)(iv)(I).

(4) Section 401(a)(9)(C).

(5) Section 408(b).

(6) Section 457(d)(1)(A).

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to years beginning after December 31, 1996.

SEC. 1209. DISTRIBUTIONS UNDER RURAL COOPERATIVE PLANS.

(a) DISTRIBUTIONS FOR HARDSHIP OR AFTER A CERTAIN AGE.—Section 401(k)(7) is amended by adding at the end the following new subparagraph:

"(C) SPECIAL RULE FOR CERTAIN DISTRIBUTIONS.—A rural cooperative plan which includes a qualified cash or deferred arrangement shall not be treated as violating the requirements of section 401(a) or of paragraph (2) merely because, under the plan, distributions may be made by reason of hardship or the attainment of age 59½. For purposes of this section, the term 'hardship distribution' means a distribution described in paragraph (2)(B)(i)(IV) (without regard to the limitation of its application to profit-sharing or stock bonus plans)."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to distributions after the date of the enactment of this Act.

SEC. 1210. MODIFICATION OF ADDITIONAL PARTICIPATION REQUIREMENTS.

(a) GENERAL RULE.—Section 401(a)(26)(A) (relating to additional participation requirements) is amended to read as follows:

"(A) IN GENERAL.—In the case of a trust which is a part of a defined benefit plan, such trust shall not constitute a qualified trust under this subsection unless, on each day of the plan year, such plan benefits at least the lesser of—

"(i) 50 employees of the employer, or

"(ii) the greater of—

"(I) 40 percent of all employees of the employer, or

"(II) 2 employees (or if there is only 1 employee, such employee)."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to plan years beginning after December 31, 1996.

SEC. 1211. UNIFORM RETIREMENT AGE.

(a) DISCRIMINATION TESTING.—Paragraph (5) of section 401(a) (relating to special rules relating to nondiscrimination requirements) is amended by adding at the end the following new subparagraph:

"(F) SOCIAL SECURITY RETIREMENT AGE.—For purposes of testing for discrimination under paragraph (4)—

"(i) the social security retirement age (as defined in section 415(b)(8)) shall be treated as a uniform retirement age, and

"(ii) subsidized early retirement benefits and joint and survivor annuities shall not be treated as being unavailable to employees on the same terms merely because such benefits or annuities are based in whole or in part on an employee's social security retirement age (as so defined)."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to plan years beginning after December 31, 1996.

SEC. 1212. TREATMENT OF LEASED EMPLOYEES.

(a) GENERAL RULE.—Subparagraph (C) of section 414(n)(2) (defining leased employee) is amended to read as follows:

"(C) such services are performed under significant direction or control by the recipient."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to years beginning after Decem-

ber 31, 1996, but shall not apply to any relationship determined under an Internal Revenue Service ruling issued before the date of the enactment of this Act pursuant to section 414(n)(2)(C) of the Internal Revenue Code of 1986 (as in effect on the day before such date) not to involve a leased employee.

SEC. 1213. FULL FUNDING LIMITATION FOR MULTIEMPLOYER PLANS.

(a) FULL-FUNDING LIMITATION.—Section 412(c)(7)(C) (relating to full-funding limitation) is amended—

(1) by inserting "or in the case of a multiemployer plan," after "paragraph (6)(B),", and

(2) by inserting "AND MULTIEMPLOYER PLANS" after "PARAGRAPH (6)(B)" in the heading thereof.

(b) VALUATION.—Section 412(c)(9) is amended—

(1) by inserting "(3 years in the case of a multiemployer plan)" after "year", and

(2) by striking "ANNUAL VALUATION" in the heading and inserting "VALUATION".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to plan years beginning after December 31, 1996.

SEC. 1214. ELIMINATION OF PARTIAL TERMINATION RULES FOR MULTIEMPLOYER PLANS.

(a) PARTIAL TERMINATION RULES FOR MULTIEMPLOYER PLANS.—Section 411(d)(3) is amended by adding at the end the following new sentence: "This paragraph shall not apply in the case of a partial termination of a multiemployer plan."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to partial terminations beginning after December 31, 1996.

SEC. 1215. ELECTIVE DEFERRALS UNDER SECTION 403(b).

(a) IN GENERAL.—Subparagraph (E) of section 403(b)(1) is amended to read as follows:

"(E) in the case of a contract purchased under a salary reduction agreement, the contract meets the requirements of section 401(a)(30),".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to years beginning after December 31, 1996.

SEC. 1216. UNIFORM PENALTY PROVISIONS TO APPLY TO CERTAIN PENSION REPORTING REQUIREMENTS.

(a) PENALTIES.—

(1) STATEMENTS.—Paragraph (1) of section 6724(d) is amended by striking "and" at the end of

subparagraph (A), by striking the period at the end of subparagraph (B) and inserting ", and", and by inserting after subparagraph (B) the following new subparagraph:

"(C) any statement required to be made to the Secretary under—

"(i) section 408(i) (relating to reports with respect to individual retirement accounts or annuities), or

"(ii) section 6047(d) (relating to reports by employers, plan administrators, etc.)."

(2) REPORTS.—Paragraph (2) of section 6724(d) is amended by striking "or" at the end of subparagraph (S), by striking the period at the end of subparagraph (T) and inserting a comma, and by inserting after subparagraph (T) the following new subparagraphs:

"(U) section 408(i) (relating to reports with respect to individual retirement plans) to any person other than the Secretary, or

"(V) section 6047(d) (relating to reports by plan administrators) to any person other than the Secretary."

(3) PENALTIES.—

(A) Section 6721(e)(2)(A) is amended by striking "or 6050L" and inserting "6050L, or 408(i)".

(B) Section 6722(c)(1)(A) is amended by striking "or 6050L(c)" and inserting "6050L(c), or 408(i)".

(b) MODIFICATION OF REPORTABLE DESIGNATED DISTRIBUTIONS.—

(1) SECTION 408.—Subsection (i) of section 408 (relating to individual retirement account reports) is amended by inserting "aggregating $10 or more in any calendar year" after "distributions".

(2) SECTION 6047.—Paragraph (1) of section 6047(d) (relating to reports by employers, plan administrators, etc.) is amended by adding at the end the following new sentence: "No return or report may be required under the preceding sentence with respect to distributions to any person during any year unless such distributions aggregate $10 or more."

(c) CONFORMING AMENDMENTS.—

(1) Paragraph (1) of section 6047(f) is amended to read as follows:

"(1) For provisions relating to penalties for failures to file returns and reports required under this section, see sections 6652(e), 6721, and 6722."

(2) Subsection (e) of section 6652 is amended by adding at the end the following new sentence: "This subsection shall not apply to any return or statement which is an information return described in section 6724(d)(1)(C)(ii) or a payee statement described in section 6724(d)(2)(V)."

(3) Subsection (a) of section 6693 is amended by adding at the end the following new sentence: "This subsection shall not apply to any report which is an information return described in section 6724(d)(1)(C)(i) or a payee statement described in section 6724(d)(2)(U)."

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to returns, reports, and other statements the due date for which (determined without regard to extensions) is after December 31, 1996.

SEC. 1217. TAX ON PROHIBITED TRANSACTIONS.

(a) IN GENERAL.—Section 4975(a) is amended by striking "5 percent" and inserting "10 percent".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to prohibited transactions occurring after the date of the enactment of this Act.

SEC. 1218. DATE FOR ADOPTION OF PLAN AMENDMENTS.

(a) IN GENERAL.—If any amendment made by this subtitle requires an amendment to any plan, such plan amendment shall not be required to be made before the last day of the first plan year beginning on or after January 1, 1998, if—

(1) during the period after such amendment takes effect and before the last day of such first plan year, the plan is operated in accordance with the requirements of such amendment, and

(2) such plan amendment applies retroactively to such period.

(b) GOVERNMENTAL PLANS.—In the case of a governmental plan (as defined in section 414(d) of the Internal Revenue Code of 1986), subsection (a) shall be applied by substituting for "January 1, 1998" the later of—

(1) January 1, 1999, or

(2) the date which is 90 days after the opening of the first legislative session beginning after January 1, 1999, of the governing body with authority to amend the plan, but only if such governing body does not meet continuously.

Subtitle B—Expanded Individual Retirement Accounts to Increase Coverage and Portability

CHAPTER 1—RETIREMENT SAVINGS INCENTIVES

Subchapter A—IRA Deduction

SEC. 1301. INCREASE IN INCOME LIMITATIONS.

(a) IN GENERAL.—Subparagraph (B) of section 219(g)(3) is amended—

(1) by striking "$40,000" in clause (i) and inserting "$80,000 ($70,000 in the case of taxable years beginning in 1996, 1997, or 1998)", and

(2) by striking "$25,000" in clause (ii) and inserting "$50,000 ($45,000 in the case of taxable years beginning in 1996, 1997, or 1998)".

(b) PHASEOUT OF LIMITATIONS.—Clause (ii) of section 219(g)(2)(A) is amended by striking "$10,000" and inserting "an amount equal to 10 times the dollar amount applicable for the taxable year under subsection (b)(1)(A)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1995.

SEC. 1302. INFLATION ADJUSTMENT FOR DEDUCTIBLE AMOUNT AND INCOME LIMITATIONS.

(a) IN GENERAL.—Section 219 is amended by redesignating subsection (h) as subsection (i) and by inserting after subsection (g) the following new subsection:

"(h) COST-OF-LIVING ADJUSTMENTS.—

"(1) DEDUCTIBLE AMOUNTS.—In the case of any taxable year beginning in a calendar year after 1996, the $2,000 amounts under subsections (b)(1)(A) and (c)(2) shall be increased by an amount equal to—

"(A) such dollar amount, multiplied by

"(B) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting 'calendar year 1995' for 'calendar year 1992' in subparagraph (B) thereof.

"(2) APPLICABLE DOLLAR AMOUNT.—In the case of any taxable year beginning in a calendar year after 1999, the applicable dollar amounts under subsection (g)(3)(B) shall be increased by an amount equal to—

"(A) such dollar amount, multiplied by

"(B) the cost-of-living adjustment determined under section 1(f)(3) for the calendar

year in which the taxable year begins, determined by substituting 'calendar year 1998' for 'calendar year 1992' in subparagraph (B) thereof.

"(3) ROUNDING RULES.—

"(A) DEDUCTION AMOUNTS.—If any amount after adjustment under paragraph (1) is not a multiple of $500, such amount shall be rounded to the next lowest multiple of $500.

"(B) APPLICABLE DOLLAR AMOUNTS.—If any amount after adjustment under paragraph (2) is not a multiple of $5,000, such amount shall be rounded to the next lowest multiple of $5,000."

(b) CONFORMING AMENDMENTS.—

(1) Clause (i) of section 219(c)(2)(A) is amended to read as follows:

"(i) the sum of $250 and the dollar amount in effect for the taxable year under subsection (b)(1)(A), or".

(2) Section 408(a)(1) is amended by striking "in excess of $2,000 on behalf of any individual" and inserting "on behalf of any individual in excess of the amount in effect for such taxable year under section 219(b)(1)(A)".

(3) Section 408(b)(2)(B) is amended by striking "$2,000" and inserting "the dollar amount in effect under section 219(b)(1)(A)".

(4) Subparagraph (A) of section 408(d)(5) is amended by striking "$2,250" and inserting "the dollar amount in effect for the taxable year under section 219(c)(2)(A)(i)".

(5) Section 408(j) is amended by striking "$2,000".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1995.

SEC. 1303. COORDINATION OF IRA DEDUCTION LIMIT WITH ELECTIVE DEFERRAL LIMIT.

(a) IN GENERAL.—Section 219(b) (relating to maximum amount of deduction) is amended by adding at the end the following new paragraph:

"(4) COORDINATION WITH ELECTIVE DEFERRAL LIMIT.—The amount determined under paragraph (1) or subsection (c)(2) with respect to any individual for any taxable year shall not exceed the excess (if any) of—

"(A) the limitation applicable for the taxable year under section 402(g)(1), over

"(B) the elective deferrals (as defined in section 402(g)(3)) of such individual for such taxable year."

(b) CONFORMING AMENDMENT.—Section 219(c) is amended by adding at the end the following new paragraph:

"(3) CROSS REFERENCE.—

"For reduction in paragraph (2) amount, see subsection (b)(4)."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1995.

Subchapter B—Nondeductible Tax-Free IRAs

SEC. 1311. ESTABLISHMENT OF NONDEDUCTIBLE TAX-FREE INDIVIDUAL RETIREMENT ACCOUNTS.

(a) IN GENERAL.—Subpart A of part I of subchapter D of chapter 1 (relating to pension, profit-sharing, stock bonus plans, etc.) is amended by inserting after section 408 the following new section:

"SEC. 408A. SPECIAL INDIVIDUAL RETIREMENT ACCOUNTS.

"(a) GENERAL RULE.—Except as provided in this chapter, a special individual retirement account shall be treated for purposes of this title in the same manner as an individual retirement plan.

"(b) SPECIAL INDIVIDUAL RETIREMENT ACCOUNT.—For purposes of this title, the term 'special indi-

vidual retirement account' means an individual retirement plan which is designated at the time of establishment of the plan as a special individual retirement account.

"(c) TREATMENT OF CONTRIBUTIONS.—

"(1) NO DEDUCTION ALLOWED.—No deduction shall be allowed under section 219 for a contribution to a special individual retirement account.

"(2) CONTRIBUTION LIMIT.—The aggregate amount of contributions for any taxable year to all special individual retirement accounts maintained for the benefit of an individual shall not exceed the excess (if any) of—

"(A) the maximum amount allowable as a deduction under section 219 with respect to such individual for such taxable year, over

"(B) the aggregate amount of contributions for such taxable year to all individual retirement plans (other than special individual retirement accounts) maintained for the benefit of the individual.

"(3) SPECIAL RULES FOR QUALIFIED TRANSFERS.—

"(A) IN GENERAL.—No rollover contribution may be made to a special individual retirement account unless it is a qualified transfer.

"(B) LIMIT NOT TO APPLY.—The limitation under paragraph (2) shall not apply to a qualified transfer to a special individual retirement account.

"(d) TAX TREATMENT OF DISTRIBUTIONS.—

"(1) IN GENERAL.—Except as provided in this subsection, any amount paid or distributed out of a special individual retirement account shall not be included in the gross income of the distributee.

"(2) EXCEPTION FOR EARNINGS ON CONTRIBUTIONS HELD LESS THAN 5 YEARS.—

"(A) IN GENERAL.—Any amount distributed out of a special individual retirement account which consists of earnings allocable to contributions made to the account during the 5-year period ending on the day before such distribution shall be included in the gross income of the distributee for the taxable year in which the distribution occurs.

"(B) ORDERING RULE.—

"(i) FIRST-IN, FIRST-OUT RULE.—Distributions from a special individual retirement account shall be treated as having been made—

"(I) first from the earliest contribution (and earnings allocable thereto) remaining in the account at the time of the distribution, and

"(II) then from other contributions (and earnings allocable thereto) in the order in which made.

"(ii) ALLOCATIONS BETWEEN CONTRIBUTIONS AND EARNINGS.—Any portion of a distribution allocated to a contribution (and earnings allocable thereto) shall be treated as allocated first to the earnings and then to the contribution.

"(iii) ALLOCATION OF EARNINGS.—Earnings shall be allocated to a contribution in such manner as the Secretary may prescribe.

"(iv) AGGREGATIONS OF CONTRIBUTIONS.—Except as provided by the Secretary, for purposes of this subparagraph—

"(I) all contributions made during the same taxable year may be treated as 1 contribution, and

"(II) all contributions made before the first day of the 5-year period ending on the day before any distribution may be treated as 1 contribution.

"(C) CROSS REFERENCE.—

"For additional tax for early withdrawal, see section 72(t).

"(3) QUALIFIED TRANSFER.—

"(A) IN GENERAL.—Paragraph (2) shall not apply to any distribution which is transferred in a qualified transfer to another special individual retirement account.

"(B) CONTRIBUTION PERIOD.—For purposes of paragraph (2), the special individual retirement account to which any contributions are transferred shall be treated as having held such contributions during any period such contributions were held (or are treated as held under this subparagraph) by the special individual retirement account from which transferred.

"(4) SPECIAL RULES RELATING TO CERTAIN TRANSFERS.—

"(A) IN GENERAL.—Notwithstanding any other provision of law, in the case of a qualified transfer to a special individual retirement ac-

count from an individual retirement plan which is not a special individual retirement account—

"(i) there shall be included in gross income any amount which, but for the qualified transfer, would be includible in gross income, but

"(ii) section 72(t) shall not apply to such amount.

"(B) TIME FOR INCLUSION.—In the case of any qualified transfer which occurs before January 1, 1998, any amount includible in gross income under subparagraph (A) with respect to such contribution shall be includible ratably over the 4-taxable year period beginning in the taxable year in which the amount was paid or distributed out of the individual retirement plan. The amount of such qualified transfer taken into account for purposes of section 4980A(c) shall be taken into account ratably over such period.

"(C) ADDITIONAL REPORTING.—A trustee of an individual retirement plan shall include such additional information in any report required under section 408(i) as the Secretary may require to insure that amounts described

in subparagraph (B) are included in gross income for the appropriate taxable year.

"(e) QUALIFIED TRANSFER.—For purposes of this section—

"(1) IN GENERAL.—The term 'qualified transfer' means a transfer to a special individual retirement account from another such account or from an individual retirement plan but only if such transfer meets the requirements of section 408(d)(3).

"(2) LIMITATION.—

"(A) IN GENERAL.—A transfer otherwise described in paragraph (1) shall not be treated as a qualified transfer if the taxpayer's adjusted gross income for the taxable year of the transfer exceeds the sum of—

"(i) the applicable dollar amount, plus

"(ii) the dollar amount applicable for the taxable year under section 219(g)(2)(A)(ii).

This subparagraph shall not apply to a transfer from a special individual retirement account to another special individual retirement account.

"(B) TRANSITION RULE.—In the case of a transfer before January 1, 1999, the dollar limitation under subparagraph (A) shall be

$100,000 in the case of a married individual filing a joint return, zero in the case of a married individual filing a separate return, and $70,000 in any other case.

"(3) DEFINITIONS.—For purposes of this subsection, the terms 'adjusted gross income' and 'applicable dollar amount' have the meanings given such terms by section 219(g)(3), except that adjusted gross income shall be determined by taking into account the deduction under section 219 and not taking into account any transfer to which paragraph (2) applies."

(b) ADDITIONAL TAX ON EARLY DISTRIBUTIONS.—Section 72(t) is amended by adding at the end the following new paragraph:

"(6) RULES RELATING TO SPECIAL INDIVIDUAL RETIREMENT ACCOUNTS.—In the case of a special individual retirement account under section 408A—

"(A) this subsection shall only apply to distributions out of such account which consist of earnings allocable to contributions made to the account during the 5-year period ending on the day before such distribution, and

"(B) paragraph (2)(A)(i) shall not apply to any distribution described in subparagraph (A)."

(c) EXCESS CONTRIBUTIONS.—Section 4973(b) is amended—

(1) by inserting ", or a qualified transfer described in section 408A(e)" after "408(d)(3)" in paragraph (1)(A), and

(2) by adding at the end the following new sentence: "For purposes of paragraphs (1)(B) and (2)(C), the amount allowable as a deduction under section 219 shall be computed without regard to section 408A."

(d) REPORTING.—Section 408(i) is amended by striking "under regulations" and "in such regulations" each place such terms appear.

(e) CONFORMING AMENDMENT.—The table of sections for subpart A of part I of subchapter D of chapter 1 is amended by inserting after the item relating to section 408 the following new item:

"Sec. 408A. Special individual retirement accounts."

(f) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1995.

CHAPTER 2—DISTRIBUTIONS AND INVESTMENTS

SEC. 1321. DISTRIBUTIONS FROM IRAS MAY BE USED WITHOUT ADDITIONAL TAX TO PURCHASE FIRST HOMES, TO PAY HIGHER EDUCATION OR FINANCIALLY DEVASTATING MEDICAL EXPENSES, OR BY THE UNEMPLOYED.

(a) IN GENERAL.—Paragraph (2) of section 72(t) (relating to exceptions to 10-percent additional tax on early distributions from qualified retirement plans) is amended by adding at the end the following new subparagraph:

"(D) DISTRIBUTIONS FROM CERTAIN PLANS FOR FIRST HOME PURCHASES OR EDUCATIONAL EXPENSES.—Distributions to an individual from an individual retirement plan—

"(i) which are qualified first-time homebuyer distributions (as defined in paragraph (7)); or

"(ii) to the extent such distributions do not exceed the qualified higher education expenses (as defined in paragraph (8)) of the taxpayer for the taxable year."

(b) FINANCIALLY DEVASTATING MEDICAL EXPENSES.—

(1) IN GENERAL.—Section 72(t)(3)(A) is amended by striking "(B),".

(2) CERTAIN LINEAL DESCENDANTS AND ANCESTORS TREATED AS DEPENDENTS AND LONG-TERM CARE SERVICES TREATED AS MEDICAL CARE.—Subparagraph (B) of section 72(t)(2) is amended by striking "medical care" and all that follows and inserting "medical care determined—

"(i) without regard to whether the employee itemizes deductions for such taxable year, and

"(ii) in the case of an individual retirement plan—

"(I) by treating such employee's dependents as including all children, grandchildren, and ancestors of the employee or such employee's spouse and

"(II) by treating qualified long-term care services (as defined in paragraph (9)) as medical care for purposes of this subparagraph."

(3) CONFORMING AMENDMENT.—Subparagraph (B) of section 72(t)(2) is amended by striking "or (C)" and inserting ", (C), or (D)".

(c) DEFINITIONS.—Section 72(t), as amended by this Act, is amended by adding at the end the following new paragraphs:

"(7) QUALIFIED FIRST-TIME HOMEBUYER DISTRIBUTIONS.—For purposes of paragraph (2)(D)(i)—

"(A) IN GENERAL.—The term 'qualified first-time homebuyer distribution' means any payment or distribution received by an individual to the extent such payment or distribution is used by the individual before the close of the 60th day after the day on which such payment or distribution is received to pay qualified acquisition costs with respect to a principal residence of a first-time homebuyer who is such individual or the spouse, child (as defined in section 151(c)(3)), or grandchild of such individual.

"(B) QUALIFIED ACQUISITION COSTS.—For purposes of this paragraph, the term 'qualified acquisition costs' means the costs of acquiring, constructing, or reconstructing a residence. Such term includes any usual or reasonable settlement, financing, or other closing costs.

"(C) FIRST-TIME HOMEBUYER; OTHER DEFINITIONS.—For purposes of this paragraph—

"(i) FIRST-TIME HOMEBUYER.—The term 'first-time homebuyer' means any individual if—

"(I) such individual (and if married, such individual's spouse) had no present ownership interest in a principal residence during the 3-year period ending on the date of acquisition of the principal residence to which this paragraph applies, and

"(II) subsection (h) or (k) of section 1034 did not suspend the running of any period of time specified in section 1034 with respect to such individual on the day before the date the distribution is applied pursuant to subparagraph (A).

In the case of an individual described in section 143(i)(1)(C) for any year, an ownership interest shall not include any interest under a contract of deed described in such section. An individual who loses an

ownership interest in a principal residence incident to a divorce or legal separation is deemed for purposes of this subparagraph to have had no ownership interest in such principal residence within the period referred to in subclause (II).

"(ii) PRINCIPAL RESIDENCE.—The term 'principal residence' has the same meaning as when used in section 1034.

"(iii) DATE OF ACQUISITION.—The term 'date of acquisition' means the date—

"(I) on which a binding contract to acquire the principal residence to which subparagraph (A) applies is entered into, or

"(II) on which construction or reconstruction of such a principal residence is commenced.

"(D) SPECIAL RULE WHERE DELAY IN ACQUISITION.—Any portion of any distribution from any individual retirement plan which fails to meet the requirements of subparagraph (A) solely by reason of a delay or cancellation of the purchase or construction of the residence may be contributed to an individual retirement plan

as provided in section 408(d)(3)(A)(i) (determined by substituting '120 days' for '60 days' in such section), except that—

"(i) section 408(d)(3)(B) shall not be applied to such portion, and

"(ii) such portion shall not be taken into account in determining whether section 408(d)(3)(B) applies to any other amount.

"(8) QUALIFIED HIGHER EDUCATION EXPENSES.—For purposes of paragraph (2)(D)(ii)—

"(A) IN GENERAL.—The term 'qualified higher education expenses' means tuition and fees required for the enrollment or attendance of—

"(i) the taxpayer,

"(ii) the taxpayer's spouse,

"(iii) a dependent of the taxpayer with respect to whom the taxpayer is allowed a deduction under section 151, or

"(iv) the taxpayer's child (as defined in section 151(c)(3)) or grandchild,

as an eligible student at an institution of higher education.

"(B) EXCEPTIONS.—The term 'qualified higher education expenses' does not include—

"(i) expenses with respect to any course or other education involving sports, games, or hobbies, unless such expenses—

"(I) are part of a degree program, or

"(II) are deductible under this chapter without regard to this section; or

"(ii) any student activity fees, athletic fees, insurance expenses, or other expenses unrelated to a student's academic course of instruction.

"(C) COORDINATION WITH SAVINGS BOND PROVISIONS.—The amount of qualified higher education expenses for any taxable year shall be reduced by any amount excludable from gross income under section 135.

"(D) ELIGIBLE STUDENT.—For purposes of subparagraph (A), the term 'eligible student' means a student who—

"(i) meets the requirements of section 484(a)(1) of the Higher Education Act of 1965 (20 U.S.C. 1091(a)(1)), as in effect

on the date of the enactment of this section, and

"(ii)(I) is carrying at least one-half the normal full-time work load for the course of study the student is pursuing, as determined by the institution of higher education, or

"(II) is enrolled in a course which enables the student to improve the student's job skills or to acquire new job skills.

"(E) INSTITUTION OF HIGHER EDUCATION.—The term 'institution of higher education' means an institution which—

"(i) is described in section 481 of the Higher Education Act of 1965 (20 U.S.C. 1088), as in effect on the date of the enactment of this section, and

"(ii) is eligible to participate in programs under title IV of such Act.

"(9) QUALIFIED LONG-TERM CARE SERVICES.—For purposes of paragraph (2)(B)—

"(A) IN GENERAL.—The term 'qualified long-term care services' means necessary diagnostic, curing, mitigating, treating, preventive, therapeutic, and rehabilitative services, and

maintenance and personal care services (whether performed in a residential or nonresidential setting) which—

"(i) are required by an individual during any period the individual is an incapacitated individual (as defined in subparagraph (B)),

"(ii) have as their primary purpose—

"(I) the provision of needed assistance with 1 or more activities of daily living (as defined in subparagraph (C)), or

"(II) protection from threats to health and safety due to severe cognitive impairment, and

"(iii) are provided pursuant to a continuing plan of care prescribed by a licensed professional (as defined in subparagraph (D)).

"(B) INCAPACITATED INDIVIDUAL.—The term 'incapacitated individual' means any individual who—

"(i) is unable to perform, without substantial assistance from another individual (including assistance involving cueing or

substantial supervision), at least 2 activities of daily living as defined in subparagraph (C), or

"(ii) has severe cognitive impairment as defined by the Secretary in consultation with the Secretary of Health and Human Services.

Such term shall not include any individual otherwise meeting the requirements of the preceding sentence unless, within the preceding 12-month period, a licensed professional has certified that such individual meets such requirements.

"(C) ACTIVITIES OF DAILY LIVING.—Each of the following is an activity of daily living:

"(i) Eating.

"(ii) Toileting.

"(iii) Transferring.

"(iv) Bathing.

"(v) Dressing.

"(D) LICENSED PROFESSIONAL.—The term 'licensed professional' means—

"(i) a physician or registered professional nurse, or

"(ii) any other individual who meets such requirements as may be prescribed by the Secretary after consultation with the Secretary of Health and Human Services.

"(E) CERTAIN SERVICES NOT INCLUDED.—The term 'qualified long-term care services' shall not include any services provided to an individual—

"(i) by a relative (directly or through a partnership, corporation, or other entity) unless the relative is a licensed professional with respect to such services, or

"(ii) by a corporation or partnership which is related (within the meaning of section 267(b) or 707(b)) to the individual.

For purposes of this subparagraph, the term 'relative' means an individual bearing a relationship to the individual which is described in paragraphs (1) through (8) of section 152(a)."

(d) DISTRIBUTIONS FOR CERTAIN UNEMPLOYED INDIVIDUALS.—Paragraph (2) of section 72(t) is amended by adding at the end the following new subparagraph:

"(E) DISTRIBUTIONS TO UNEMPLOYED INDIVIDUALS.—A distribution from an individual

retirement plan to an individual after separation from employment, if—

"(i) such individual has received unemployment compensation for 12 consecutive weeks under any Federal or State unemployment compensation law by reason of such separation, and

"(ii) such distributions are made during any taxable year during which such unemployment compensation is paid or the succeeding taxable year."

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to payments and distributions after December 31, 1995.

SEC. 1322. CONTRIBUTIONS MUST BE HELD AT LEAST 5 YEARS IN CERTAIN CASES.

(a) IN GENERAL.—Section 72(t), as amended by this Act, is amended by adding at the end the following new paragraph:

"(10) CERTAIN CONTRIBUTIONS MUST BE HELD 5 YEARS.—

"(A) IN GENERAL.—Paragraph (2)(A)(i) shall not apply to any amount distributed out of an individual retirement plan (other than a special individual retirement account) which is

allocable to contributions made to the plan during the 5-year period ending on the date of such distribution (and earnings on such contributions).

"(B) ORDERING RULE.—For purposes of this paragraph—

"(i) FIRST-IN, FIRST-OUT RULE.—Distributions shall be treated as having been made—

"(I) first from the earliest contribution (and earnings allocable thereto) remaining in the account at the time of the distribution, and

"(II) then from other contributions (and earnings allocable thereto) in the order in which made.

"(ii) ALLOCATION OF EARNINGS.—Earnings shall be allocated to contributions in such manner as the Secretary may prescribe.

"(iii) AGGREGATIONS OF CONTRIBUTIONS.—Except as provided by the Secretary, for purposes of this subparagraph—

"(I) all contributions made during the same taxable year may be treated as 1 contribution, and

"(II) all contributions made before the first day of the 5-year period ending on the day before any distribution may be treated as 1 contribution.

"(C) SPECIAL RULE FOR ROLLOVERS.—

"(i) PENSION PLANS.—Subparagraph (A) shall not apply to distributions out of an individual retirement plan which are allocable to rollover contributions to which section 402(c), 403(a)(4), or 403(b)(8) applied.

"(ii) CONTRIBUTION PERIOD.—For purposes of subparagraph (A), amounts shall be treated as having been held by a plan during any period such contributions were held (or are treated as held under this clause) by any individual retirement plan from which transferred.

"(D) SPECIAL ACCOUNTS.—For rules applicable to special individual retirement accounts under section 408A, see paragraph (8)."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to contributions (and earnings allocable thereto) which are made after December 31, 1995.

SEC. 1323. INVESTMENTS IN QUALIFIED STATE PREPAID TUITION PROGRAMS.

(a) IN GENERAL.—Section 408, as amended by section 1101, is amended by redesignating subsection (q) as subsection (r) and by inserting after subsection (p) the following new subsection:

"(q) SPECIAL RULES FOR QUALIFIED STATE PREPAID TUITION PROGRAM INSTRUMENTS.—

"(1) IN GENERAL.—In the case of a qualified State prepaid tuition program instrument to which this subsection applies—

"(A) the use of all or part of the assets of an individual retirement plan to purchase such an instrument shall be treated for purposes of this section as for the exclusive benefit of the individual for whom the plan was established or the individual's beneficiaries, and

"(B) to the extent such instrument is converted into tuition and fees as provided in paragraph (3)(B)(i), such individual (or such beneficiaries) shall be treated—

"(i) for purposes of subsection (d) as having received a distribution in an amount equal to such tuition and fees (as of the time of the conversion), and

"(ii) for purposes of section 72(t)(2)(D)(ii), as having incurred qualified higher education expenses to the extent such tuition and fees otherwise constitute such expenses.

"(2) INSTRUMENTS TO WHICH SUBSECTION APPLIES.—To the extent provided by the Secretary, this subsection shall apply to any qualified State prepaid tuition program instrument if—

"(A) the instrument is purchased by the individual retirement plan directly from the State or an instrumentality thereof, and

"(B) the beneficiary designated under the instrument is the taxpayer, the taxpayer's spouse, a dependent of the taxpayer with respect to whom the taxpayer is allowed a deduction under section 151, or the taxpayer's child (as defined in section 151(c)(3)) or grandchild.

"(3) QUALIFIED STATE PREPAID TUITION PROGRAM INSTRUMENT.—For purposes of this sub-

section, the term 'qualified State prepaid tuition program instrument' means an instrument which—

"(A) is issued under a program established and maintained by a State, and

"(B) which may only be—

"(i) converted into a percentage (determined as of the time of purchase) of tuition and fees which would constitute qualified higher education expenses (within the meaning of section 72(t)(8)) if the beneficiary designated under the instrument enrolls in or attends an institution of higher education specified in the instrument as an eligible student, or

"(ii) redeemed for an amount not less than the purchase price (less any reasonable administrative fees) if the instrument is not converted as provided in clause (i).

"(4) DEFINITIONS.—For purposes of this subsection, the terms 'institution of higher education' and 'eligible student' have the meanings given such terms by section 72(t)(8)."

(b) EXEMPTION FROM PROHIBITED TRANSACTIONS.—Section 4975(d) is amended by striking "or" at the end of paragraph (14), by striking the period at

the end of paragraph (15) and inserting "; or", and by inserting after paragraph (15) the following new paragraph:

"(16) any purchase of a qualified State prepaid tuition program instrument to which section 408(q) applies."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1995.

CHAPTER 3—TERMINATION OF CERTAIN PROVISIONS

SEC. 1331. TERMINATION OF CERTAIN PROVISIONS.

(a) TERMINATION OF INFLATION ADJUSTMENT FOR IRA LIMITATIONS.—The dollar amounts applicable under section 219 of the Internal Revenue Code of 1986 shall be determined without regard to subsection (h) of such section in the case of taxable years beginning after December 31, 2000.

(b) TERMINATION OF CONTRIBUTIONS TO SPECIAL INDIVIDUAL RETIREMENT ACCOUNTS.—No contribution may be made after December 31, 2000, to any special individual retirement account (within the meaning of section 408A of such Code).

(c) TERMINATION OF TRANSFERS TO SPECIAL INDIVIDUAL RETIREMENT ACCOUNTS FROM REGULAR INDI-

VIDUAL RETIREMENT ACCOUNTS.—For purposes of section 408A of such Code, the term "qualified transfer" shall not include any transfer after December 31, 2000, to a special individual retirement account from any account other than a special individual retirement account.

(d) APPLICATION OF EARLY WITHDRAWAL TAX.—The amendments made by the following provisions shall not apply to any distribution after December 31, 2000:

(1) Section 1311(b) (relating to exception for distributions from special individual retirement accounts allocable to contributions held at least 5 years).

(2) Section 1321 (relating to distributions from IRAs may be used without additional tax to purchase first homes, to pay higher education or financially devastating medical expenses, or by the unemployed).

(3) Section 1322 (relating to exception for distributions allocable to contributions held at least 5 years)

(e) TERMINATION OF INCREASES IN CERTAIN LIMITATIONS.—The amendments made by the following provisions shall not apply to any taxable year beginning after December 31, 2000:

(1) Section 1301 (relating to increase in income limitations for individual retirement plans).

(2) Section 1303 (relating to coordination of IRA deduction limit with elective deferral limit).

Subtitle C—Other Expansions of Pension Portability

SEC. 1401. ALTERNATIVE NONDISCRIMINATION RULES FOR CERTAIN PLANS THAT PROVIDE FOR EARLY PARTICIPATION.

(a) CASH OR DEFERRED ARRANGEMENTS.—Paragraph (3) of section 401(k) (relating to application of participation and discrimination standards), as amended by section 1103(d), is amended by adding at the end the following new subparagraph:

"(F) SPECIAL RULE FOR EARLY PARTICIPATION.—If an employer elects to apply section 410(b)(4)(B) in determining whether a cash or deferred arrangement meets the requirements of subparagraph (A)(i), the employer may, in determining whether the arrangement meets the requirements of subparagraph (A)(ii), exclude from consideration all eligible employees (other than highly compensated employees) who have not met the minimum age and service requirements of section 410(a)(1)(A)."

(b) MATCHING CONTRIBUTIONS.—Paragraph (5) of section 401(m) (relating to employees taken into consideration) is amended by adding at the end the following new subparagraph:

"(C) SPECIAL RULE FOR EARLY PARTICIPATION.—If an employer elects to apply section 410(b)(4)(B) in determining whether a plan meets the requirements of section 410(b), the employer may, in determining whether the plan meets the requirements of paragraph (2), exclude from consideration all eligible employees (other than highly compensated employees) who have not met the minimum age and service requirements of section 410(a)(1)(A)."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to plan years beginning after December 31, 1996.

SEC. 1402. TREATMENT OF CERTAIN VETERANS' REEMPLOYMENT RIGHTS.

(a) IN GENERAL.—Section 414 is amended by adding at the end the following new subsection:

"(u) SPECIAL RULES RELATING TO VETERANS' REEMPLOYMENT RIGHTS UNDER USSERA.—

"(1) TREATMENT OF CERTAIN CONTRIBUTIONS MADE PURSUANT TO VETERANS' REEMPLOYMENT

RIGHTS UNDER USERRA.—If any contribution is made by an employer or an employee under an individual account plan with respect to an employee, or by an employee to a defined benefit plan that provides for employee contributions, and such contribution is required by reason of such employee's rights under chapter 43 of title 38, United States Code, resulting from qualified military service, then—

"(A) such contribution shall not be subject to any otherwise applicable limitation contained in section 402(g), 402(h), 403(b), 404(a), 404(h), 408, 415, or 457, and shall not be taken into account in applying such limitations to other contributions or benefits under such plan or any other plan, with respect to the year in which the contribution is made,

"(B) such contribution shall be subject to the limitations referred to in subparagraph (A) with respect to the year to which the contribution relates (in accordance with rules prescribed by the Secretary), and

"(C) such plan shall not be treated as failing to meet the requirements of section 401(a)(4), 401(a)(26), 401(k)(3), 401(k)(11), 401(m), 403(b)(12), 408(k)(3), 408(k)(6),

408(p), 410(b), or 416 by reason of the making of (or the right to make) such contribution.

For purposes of the preceding sentence, any elective deferral or employee contribution made under paragraph (2) shall be treated as required by reason of the employee's rights under such chapter 43.

"(2) REEMPLOYMENT RIGHTS UNDER USERRA WITH RESPECT TO ELECTIVE DEFERRALS.—

"(A) IN GENERAL.—For purposes of this subchapter and section 457, if an employee is entitled to the benefits of chapter 43 of title 38, United States Code, with respect to any plan which provides for elective deferrals, the employer sponsoring the plan shall be treated as meeting the requirements of such chapter 43 with respect to such elective deferrals only if such employer—

"(i) permits such employee to make additional elective deferrals under such plan (in the amount determined under subparagraph (B) or such lesser amount as is elected by the employee) during the period which begins on the date of the reemployment of such employee with such employer and has the same length as the lesser of—

"(I) the product of 3 and the period of qualified military service which resulted in such rights, and

"(II) 5 years, and

"(ii) makes a matching contribution with respect to any additional elective deferral made pursuant to clause (i) which would have been required had such deferral actually been made during the period of such qualified military service.

"(B) AMOUNT OF MAKEUP REQUIRED.—The amount determined under this subparagraph with respect to any plan is the maximum amount of the elective deferrals that the individual would have been permitted to make under the plan in accordance with the limitations referred to in paragraph (1)(A) during the period of qualified military service if the individual had continued to be employed by the employer during such period and received compensation as determined under paragraph (7). Proper adjustment shall be made to the amount determined under the preceding sentence for any elective deferrals actually made during the period of such qualified military service.

"(C) ELECTIVE DEFERRAL.—For purposes of this paragraph, the term 'elective deferral' has the meaning given such term by section 402(g)(3); except that such term shall include any deferral of compensation under an eligible deferred compensation plan (as defined in section 457(b)).

"(D) AFTER-TAX EMPLOYEE CONTRIBUTIONS.—References in subparagraphs (A) and (B) to elective deferrals shall be treated as including references to employee contributions.

"(3) CERTAIN RETROACTIVE ADJUSTMENTS NOT REQUIRED.—For purposes of this subchapter and subchapter E, no provision of chapter 43 of title 38, United States Code, shall be construed as requiring—

"(A) any crediting of earnings to an employee with respect to any contribution before such contribution is actually made, or

"(B) any allocation of any forfeiture with respect to the period of qualified military service.

"(4) LOAN REPAYMENT SUSPENSIONS PERMITTED.—If any plan suspends the obligation to repay any loan made to an employee from such plan

for any part of any period during which such employee is performing service in the uniformed services (as defined in chapter 43 of title 38, United States Code), whether or not qualified military service, such suspension shall not be taken into account for purposes of section 72(p) or 401(a).

"(5) QUALIFIED MILITARY SERVICE.—For purposes of this subsection, the term 'qualified military service' means any service in the uniformed services (as defined in chapter 43 of title 38, United States Code) by any individual if such individual is entitled to reemployment rights under such chapter with respect to such service.

"(6) INDIVIDUAL ACCOUNT PLAN.—For purposes of this subsection, the term 'individual account plan' means any defined contribution plan (including any tax-sheltered annuity plan under section 403(b), any simplified employee pension under section 408(k), and any NEST under section 408(p)) and any eligible deferred compensation plan (as defined in section 457(b)).

"(7) COMPENSATION.—For purposes of sections 403(b)(3), 415(c)(3), and 457(e)(5), an employee who is in qualified military service shall be treated

as receiving compensation from the employer during such period of qualified military service equal to—

"(A) the compensation the employee would have received during such period if the employee were not in qualified military service, determined based on the rate of pay the employee would have received from the employer but for absence during the period of qualified military service, or

"(B) if the compensation the employee would have received during such period was not reasonably certain, the employee's average compensation from the employer during the 12-month period immediately preceding the qualified military service (or, if shorter, the period of employment immediately preceding the qualified military service).

"(8) USERRA REQUIREMENTS FOR QUALIFIED RETIREMENT PLANS.—For purposes of this subchapter and section 457, an employer sponsoring a retirement plan shall be treated as meeting the requirements of chapter 43 of title 38, United States Code, only if each of the following requirements is met:

"(A) An individual reemployed under such chapter is treated with respect to such plan as not having incurred a break in service with the employer maintaining the plan by reason of such individual's period of qualified military service.

"(B) Each period of qualified military service served by an individual is, upon reemployment under such chapter, deemed with respect to such plan to constitute service with the employer maintaining the plan for the purpose of determining the nonforfeitability of the individual's accrued benefits under such plan and for the purpose of determining the accrual of benefits under such plan.

"(C) An individual reemployed under such chapter is entitled to accrued benefits that are contingent on the making of, or derived from, employee contributions or elective deferrals only to the extent the individual makes payment to the plan with respect to such contributions or deferrals. No such payment may exceed the amount the individual would have been permitted or required to contribute had the individual remained continuously employed by the

employer throughout the period of qualified military service. Any payment to such plan shall be made during the period beginning with the date of reemployment and whose duration is 3 times the period of the qualified military service (but not greater than 5 years).

"(9) PLANS NOT SUBJECT TO TITLE 38.—This subsection shall not apply to any retirement plan to which chapter 43 of title 38, United States Code, does not apply.

"(10) REFERENCES.—For purposes of this section, any reference to chapter 43 of title 38, United States Code, shall be treated as a reference to such chapter as in effect on December 12, 1994 (without regard to any subsequent amendment)."

(b) COORDINATION WITH PROHIBITED TRANSACTION RULES.—Section 4975(d) is amended by adding at the end the following new sentence: "A loan made by a plan shall not fail to meet the requirements of paragraph (1) by reason of a loan repayment suspension described under section 414(u)(4)."

(c) EFFECTIVE DATE.—The amendments made by this section shall be effective as of December 12, 1994.

SEC. 1403. ELIMINATION OF SPECIAL VESTING RULE FOR MULTIEMPLOYER PLANS.

(a) IN GENERAL.—Paragraph (2) of section 411(a) (relating to minimum vesting standards) is amended—

(1) by striking "subparagraph (A), (B), or (C)" and inserting "subparagraph (A) or (B)"; and

(2) by striking subparagraph (C).

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to plan years beginning on or after the earlier of—

(1) the later of—

(A) January 1, 1997, or

(B) the date on which the last of the collective bargaining agreements pursuant to which the plan is maintained terminates (determined without regard to any extension thereof after the date of the enactment of this Act), or

(2) January 1, 1999.

Such amendments shall not apply to any individual who does not have more than 1 hour of service under the plan on or after the 1st day of the 1st plan year to which such amendments apply.

Subtitle D—Conforming Amendments

SEC. 1501. CONFORMING AMENDMENT RELATING TO MISSING PARTICIPANTS.

Section 401(a)(34) is amended by striking "title IV" and inserting "section 4050".

SEC. 1502. CONFORMING AMENDMENTS RELATING TO ERISA ENFORCEMENT.

(a) SPECIAL RULE FOR CERTAIN JUDGMENTS AND SETTLEMENTS.—Section 401(a)(13) is amended by adding at the end the following new subparagraphs:

"(C) SPECIAL RULE FOR CERTAIN JUDGMENTS AND SETTLEMENTS.—Subparagraph (A) shall not apply to any offset of a participant's accrued benefit in a plan against an amount that the participant is ordered or required to pay to the plan if—

"(i) the order or requirement to pay arises—

"(I) under a judgment of conviction for a crime involving such plan,

"(II) under a civil judgment (including a consent order or decree) entered by a court in an action brought in connection with a violation (or al-

leged violation) of part 4 of subtitle B of title I of the Employee Retirement Income Security Act of 1974, or

"(III) pursuant to a settlement agreement between the Secretary of Labor and the participant, or a settlement agreement between the Pension Benefit Guaranty Corporation and the participant, in connection with a violation (or alleged violation) of part 4 of subtitle B of title I of such Act,

"(ii) the judgment, order, decree, or settlement agreement expressly provides for the offset of all or part of the amount ordered or required to be paid to the plan against the participant's accrued benefit in the plan, and

"(iii) if the participant has a spouse at the time at which the offset is to be made—

"(I) such spouse has consented in writing to such offset and such consent is witnessed by a notary public or representative of the plan,

"(II) such spouse is ordered or required to pay in such judgment, order, decree, or settlement an amount to the plan in connection with a violation of part 4 of this title, or

"(III) in such judgment, order, decree, or settlement, such spouse retains the right to receive the value of the survivor annuity under a qualified joint and survivor annuity provided pursuant to paragraph (11)(A)(i) and under a qualified preretirement survivor annuity provided pursuant to paragraph 11(A)(ii), determined in accordance with subparagraph (D).

"(D) DETERMINATION OF VALUE OF SURVIVOR ANNUITY IN CONNECTION WITH OFFSET.—The value of the survivor annuity described in subparagraph (C)(iii)(III) shall be determined as if—

"(i) the participant terminated employment on the date of the offset,

"(ii) there was no offset,

"(iii) the plan permitted retirement only on or after normal retirement age,

"(iv) the plan provided only the minimum-required qualified joint and survivor annuity, and

"(v) the amount of the qualified preretirement survivor annuity under the plan is equal to the amount of the survivor annuity payable under the minimum-required qualified joint and survivor annuity.

For purposes of this subparagraph, the term 'minimum-required qualified joint and survivor annuity' means the qualified joint and survivor annuity which is the actuarial equivalent of a single annuity for the life of the participant and under which the survivor annuity is 50 percent of the amount of the annuity which is payable during the joint lives of the participant and the spouse.

"(E) WAIVER OF CERTAIN DISTRIBUTION REQUIREMENTS.—With respect to the requirements of subsections (a) and (k) of section 401, section 403(b), and section 409(d), a plan shall not be treated as failing to meet such requirements solely by reason of an offset under subparagraph (C)."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to judgments, orders, and decrees issued, and settlement agreements entered into, on or after the date of enactment of this Act.

TITLE II—ERISA PROVISIONS

SEC. 2000. AMENDMENT OF ERISA.

Except as otherwise expressly provided, whenever in this title an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Employee Retirement Income Security Act of 1974.

Subtitle A—Expanded Pension Coverage and Simplification

SEC. 2001. REPORTING AND FIDUCIARY REQUIREMENTS RELATING TO NESTS.

(a) REPORTING REQUIREMENTS.—Section 101 (29 U.S.C. 1021) is amended by redesignating subsection (g) as subsection (h) and by inserting after subsection (f) the following new subsection:

"(g) NESTs.—

"(1) IN GENERAL.—Except as provided in this subsection, no reporting or disclosure requirements under this title shall apply with respect to a pension

plan under section 408(p) of the Internal Revenue Code of 1986.

"(2) SUMMARY DESCRIPTION.—The trustee or issuer of any NEST established pursuant to a pension plan under section 408(p) of such Code shall provide to the employer maintaining the arrangement each year a description containing the following information:

"(A) The name and address of the employer and the trustee.

"(B) The requirements for eligibility for participation.

"(C) The benefits provided with respect to the arrangement.

"(D) The time and method of making elections with respect to the arrangement.

"(E) The procedures for, and effects of, distributions (including rollovers) from the arrangement.

"(3) EMPLOYEE NOTIFICATION.—The employer shall notify each employee immediately before the period for which an election described in section 408(p)(7)(B) of such Code may be made of the employee's opportunity to make such election. Such notice shall include a copy of the description described

in paragraph (2) and shall indicate whether matching contributions will be made with respect to the employee's elective contributions, and the level of employer matching and nonelective contributions which will be made, for the year for which the election may be made."

(b) FIDUCIARY DUTIES.—Section 404 (29 U.S.C. 1104) is amended by redesignating subsection (d) as subsection (e) and by adding after subsection (c) the following new subsection:

"(d)(1) In the case of a NEST established pursuant to a plan under section 408(p) of the Internal Revenue Code of 1986, no plan sponsor who is otherwise a fiduciary shall be liable under this part for any loss, or by reason of any breach, which results from—

"(A) the designation of the trustee or issuer of the NEST, or

"(B) the manner in which the assets in the NEST are invested,

after the earliest of the dates described in paragraph (2).

"(2) The dates described in this paragraph are as follows:

"(A) The date on which an affirmative election with respect to the initial investment of any con-

tribution is made by the individual for whose benefit the NEST is established.

"(B) The date on which there is a rollover of the assets of the NEST to any other NEST or individual retirement account or annuity described in section 408 of the Internal Revenue Code of 1986.

"(C) The date which is 1 year after the NEST is established.

"(3) This subsection shall not apply to a participant in a plan unless the participant is notified in writing (either separately or as part of the notice under section 101(g)(3)) that the participant's balance may be transferred without cost or penalty to another individual account or annuity in accordance with section 408(d)(3)(G) of the Internal Revenue Code of 1986."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to years beginning after December 31, 1996.

SEC. 2002. ELIMINATION OF REQUIREMENT FOR PLAN DESCRIPTIONS AND THE FILING REQUIREMENT FOR SUMMARY PLAN DESCRIPTIONS AND DESCRIPTIONS OF MATERIAL MODIFICATIONS TO A PLAN; TECHNICAL CORRECTIONS.

(a) FILING REQUIREMENTS.—Section 101(b) (29 U.S.C. 1021(b)) is amended by striking paragraphs (1),

(2), and (3) and by redesignating paragraphs (4) and (5) as paragraphs (1) and (2), respectively.

(b) PLAN DESCRIPTION.—

(1) IN GENERAL.—Section 102(a) (29 U.S.C. 1022(a)) is amended—

(A) by striking paragraph (2), and

(B) by striking "(a)(1)" and inserting "(a)".

(2) CONFORMING AMENDMENTS.—

(A) Section 102(b) (29 U.S.C. 1022(b)) is amended by striking "The plan description and summary plan description shall contain" and inserting "The summary plan description shall contain".

(B) The heading for section 102 is amended by striking "PLAN DESCRIPTION AND".

(c) FURNISHING OF REPORTS.—

(1) IN GENERAL.—Section 104(a)(1) (29 U.S.C. 1024(a)(1)) is amended to read as follows:

"SEC. 104. (a)(1) The administrator of any employee benefit plan subject to this part shall file with the Secretary the annual report for a plan year within 210 days after the close of such year (or within such time as may be required by regulations promulgated by the Secretary in order to reduce duplicative filing). The Secretary shall

make copies of such annual reports available for inspection in the public document room of the Department of Labor."

(2) SECRETARY MAY REQUEST DOCUMENTS.—

(A) IN GENERAL.—Section 104(a) (29 U.S.C. 1024(a)) is amended by adding at the end the following new paragraph:

"(6) The administrator of any employee benefit plan subject to this part shall furnish to the Secretary, upon request, any documents relating to the employee benefit plan, including but not limited to, the latest summary plan description (including any summaries of plan changes not contained in the summary plan description), and the bargaining agreement, trust agreement, contract, or other instrument under which the plan is established or operated."

(B) PENALTY.—Section 502(c) (29 U.S.C. 1132(c)) is amended by adding at the end the following new paragraph:

"(5) If, within 30 days of a request by the Secretary to a plan administrator for documents under section 104(a)(6), the plan administrator fails to furnish the material requested to the Secretary, the Secretary may assess a civil penalty against the plan administrator of up to $100 a day from the date of such failure (but in no event in excess of $1,000 per request). No penalty shall be im-

posed under this paragraph for any failure resulting from matters reasonably beyond the control of the plan administrator."

(d) CONFORMING AMENDMENTS.—

(1) Section 104(b)(1) (29 U.S.C. 1024(b)(1)) is amended by striking "section 102(a)(1)" each place it appears and inserting "section 102(a)".

(2) Section 104(b)(2) (29 U.S.C. 1024(b)(2)) is amended by striking "the plan description and" and inserting "the latest updated summary plan description and".

(3) Section 104(b)(4) (29 U.S.C. 1024(b)(4)) is amended by striking "plan description".

(4) Section 106(a) (29 U.S.C. 1026(a)) is amended by striking "descriptions,".

(5) Section 107 (29 U.S.C. 1027) is amended by striking "description or".

(6) Paragraph (2)(B) of section 108 (29 U.S.C. 1028) is amended to read as follows: "(B) after publishing or filing the annual reports,".

(7) Section 502(a)(6) (29 U.S.C. 1132(a)(6)) is amended by striking "subsection (c)(2) or (i) or (l)" and inserting "paragraph (2), (4), or (5) of subsection (c) or subsection (i) or (l)".

(e) TECHNICAL CORRECTIONS TO ERISA.—

(1) Section 502(c)(1) (29 U.S.C. 1132(c)(1)) is amended by adding at the end the following new sentence: "For purposes of this paragraph, each violation described in subparagraph (A) with respect to any single participant, and each violation described in subparagraph (B) with respect to any single participant or beneficiary, shall be treated as a separate violation."

(2) Section 502(c) (29 U.S.C. 1132(c)) is amended—

(A) by striking the last two sentences of paragraph (4), and

(B) by adding at the end the following new paragraph:

"(5) The Secretary and the Secretary of Health and Human Services shall maintain such ongoing consultation as may be necessary and appropriate to coordinate enforcement under this subsection with enforcement under section 1144(c)(9) of the Social Security Act."

(f) EFFECTIVE DATE.—The provisions of this section shall take effect on the date of the enactment of this Act.

SEC. 2003. CONFORMING AMENDMENT RELATING TO INVESTMENTS IN QUALIFIED STATE PREPAID TUITION PROGRAMS.

(a) IN GENERAL.—Subsection (b) of section 408 is amended by adding at the end the following new paragraph:

"(14) any purchase of a qualified State prepaid tuition program instrument to which section 408(q) of the Internal Revenue Code of 1986 applies."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 1995.

Subtitle B—Portability

SEC. 2011. MISSING PARTICIPANTS.

(a) IN GENERAL.—Section 4050 (29 U.S.C. 1350) is amended by redesignating subsection (c) as subsection (e) and by inserting after subsection (b) the following new subsections:

"(c) MULTIEMPLOYER PLANS.—The corporation shall prescribe rules similar to the rules in subsection (a) for multiemployer plans covered by this title that terminate under section 4041A.

"(d) PLANS NOT OTHERWISE SUBJECT TO TITLE.—

"(1) TRANSFER TO CORPORATION.—The plan administrator of a plan described in paragraph (4)

may elect to transfer a missing participant's benefits to the corporation upon termination of the plan.

"(2) INFORMATION TO THE CORPORATION.—To the extent provided in regulations, the plan administrator of a plan described in paragraph (4) shall, upon termination of the plan, provide the corporation information with respect to benefits of a missing participant if the plan transfers such benefits—

"(A) to the corporation, or

"(B) to an entity other than the corporation or a plan described in paragraph (4)(B)(ii).

"(3) PAYMENT BY THE CORPORATION.—If benefits of a missing participant were transferred to the corporation under paragraph (1), the corporation shall, upon location of the participant or beneficiary, pay to the participant or beneficiary the amount transferred (or the appropriate survivor benefit) either—

"(A) in a single sum (plus interest), or

"(B) in such other form as is specified in regulations of the corporation.

"(4) PLANS DESCRIBED.—A plan is described in this paragraph if—

"(A) the plan is a pension plan (within the meaning of section 3(2))—

"(i) to which the provisions of this section do not apply (without regard to this subsection), and

"(ii) which is not a plan described in paragraphs (2) through (11) of section 4021(b), and

"(B) at the time the assets are to be distributed upon termination, the plan—

"(i) has missing participants, and

"(ii) has not provided for the transfer of assets to pay the benefits of all missing participants to another pension plan (within the meaning of section 3(2)).

"(5) CERTAIN PROVISIONS NOT TO APPLY.—Subsections (a)(1) and (a)(3) shall not apply to a plan described in paragraph (4)."

(b) CONFORMING AMENDMENTS.—Section 206(f) (29 U.S.C. 1056(f)) is amended—

(1) by striking "title IV" and inserting "section 4050", and

(2) by striking "the plan shall provide that".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to distributions made after final regulations implementing subsections (c) and (d) of section 4050 of the Employee Retirement Income Security

Act of 1974 (as added by subsection (a)), respectively, are prescribed.

SEC. 2012. ELIMINATION OF SPECIAL VESTING RULE FOR MULTIEMPLOYER PLANS.

(a) IN GENERAL.—Paragraph (2) of section 203(a) (29 U.S.C. 1053(a)) is amended—

(1) by striking "subparagraph (A), (B), or (C)" and inserting "subparagraph (A) or (B)"; and

(2) by striking subparagraph (C).

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to plan years beginning on or after the earlier of—

(1) the later of—

(A) January 1, 1997, or

(B) the date on which the last of the collective bargaining agreements pursuant to which the plan is maintained terminates (determined without regard to any extension thereof after the date of the enactment of this Act), or

(2) January 1, 1999.

Such amendments shall not apply to any individual who does not have more than 1 hour of service under the plan on or after the 1st day of the 1st plan year to which such amendments apply.

SEC. 2013. TREATMENT OF LOANS DURING MILITARY SERVICE.

(a) IN GENERAL.—Section 408(b)(1) (29 U.S.C. 1148(b)) is amended by adding at the end the following new sentence: "A loan made by a plan shall not fail to meet the requirements of the preceding sentence by reason of a loan repayment suspension described under section 414(u)(4) of the Internal Revenue Code of 1986."

(b) EFFECTIVE DATE.—The amendment made by this section shall be effective as of December 12, 1994.

Subtitle C—Enhanced Security

CHAPTER 1—GENERAL PROVISIONS

SEC. 2021. MULTIEMPLOYER PLAN BENEFITS GUARANTEED.

(a) IN GENERAL.—Section 4022A(c) (29 U.S.C. 1322a(c)) is amended—

(1) by striking "$5" each place it appears in paragraph (1) and inserting "$11",

(2) by striking "$15" in paragraph (1) and inserting "$33", and

(3) by striking paragraphs (2), (5), and (6) and by redesignating paragraphs (3) and (4) as paragraphs (2) and (3), respectively.

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to any multiemployer plan that has not received financial assistance (within the meaning of

section 4261 of the Employee Retirement Income Security Act of 1974) within the 1-year period ending on the date of the enactment of this Act.

SEC. 2022. REVERSION REPORT.

(a) IN GENERAL.—Section 4008 (29 U.S.C. 1308) is amended by adding at the end the following new subsection:

"(b) REVERSION REPORT.—As soon as practicable after the close of each fiscal year, the Secretary of Labor (acting in the Secretary's capacity as chairman of the corporation's board) shall transmit to the President and the Congress a report providing information on plans from which residual assets were distributed to employers pursuant to section 4044(d)."

(b) CONFORMING AMENDMENT.—Section 4008 (29 U.S.C. 1308) is amended by striking "SEC. 4008." and inserting "SEC. 4008. (a) ANNUAL REPORT.—".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to fiscal years beginning after September 30, 1996.

SEC. 2023. FULL FUNDING LIMITATION FOR MULTIEMPLOYER PLANS.

(a) FULL-FUNDING LIMITATION.—Section 302(c)(7)(C) (29 U.S.C. 1082(c)(7)(C)) is amended—

(1) by inserting "or in the case of a multiemployer plan," after "paragraph (6)(B),", and

(2) by inserting "AND MULTIEMPLOYER PLANS" after "PARAGRAPH (6)(B)" in the heading thereof.

(b) VALUATION.—Section 302(c)(9) (29 U.S.C. 1082(c)(9)) is amended—

(1) by inserting "(3 years in the case of a multiemployer plan)" after "year", and

(2) by striking "ANNUAL VALUATION" in the heading and inserting "VALUATION".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to plan years beginning after December 31, 1996.

SEC. 2024. PROHIBITED TRANSACTIONS.

(a) IN GENERAL.—Section 502(i) (29 U.S.C. 1132(i)) is amended by striking "5 percent" and inserting "10 percent".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to prohibited transactions occurring after the date of enactment of this Act.

SEC. 2025. SUBSTANTIAL OWNER BENEFITS.

(a) MODIFICATION OF PHASE-IN OF GUARANTEE.—Subparagraphs (B) and (C) of section 4022(b)(5) (29 U.S.C. 1322(b)(5)) are amended to read as follows:

"(B) For purposes of this title, the term 'majority owner' has the same meaning as substantial owner under subparagraph (A), except that subparagraph (A) shall be applied by substituting '50 percent or more' for 'more than 10 percent' each place it appears.

"(C) In the case of a participant who is a majority owner, the amount of benefits guaranteed under this section shall not exceed the product of—

"(i) a fraction (not to exceed 1) the numerator of which is the number of years from the later of the effective date or the adoption date of the plan to the termination date, and the denominator of which is 30, and

"(ii) the amount of the majority owner's monthly benefits guaranteed under subsection (a) (as limited by paragraph (3) of this subsection)."

(b) MODIFICATION OF ALLOCATION OF ASSETS.—

(1) Section 4044(a)(4)(B) (29 U.S.C. 1344(a)(4)(B)) is amended by striking "section 4022(b)(5)" and inserting "section 4022(b)(5)(C)".

(2) Section 4044(b) (29 U.S.C. 1344(b)) is amended—

(A) by striking "(5)" in paragraph (2) and inserting "(4), (5),", and

(B) by redesignating paragraphs (3) through (6) as paragraphs (4) through (7), respectively, and by inserting after paragraph (2) the following new paragraph:

"(3) If assets available for allocation under paragraph (4) of subsection (a) are insufficient to satisfy in full the benefits of all individuals who are described in that paragraph, the assets shall be allocated first to benefits described in subparagraph (A) of that paragraph. Any remaining assets shall then be allocated to subparagraph (B). If assets allocated to subparagraph (B) are insufficient to satisfy in full the benefits in that subparagraph, the assets shall be allocated pro rata among individuals on the basis of the present value (as of the termination date) of their respective benefits described in that subparagraph."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to plan terminations—

(1) under section 4041(c) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1341(c)) with respect to which notices of intent to terminate are provided under section 4041(a)(2) of such Act (29 U.S.C. 1341(a)(2)) on or after the date of the enactment of this Act, or

(2) under section 4042 of such Act (29 U.S.C. 1342) with respect to which proceedings are instituted by the corporation on or after such date.

CHAPTER 2—ERISA ENFORCEMENT

SEC. 2031. SHORT TITLE.

This part may be cited as the "Pension Audit Improvement Act of 1996".

SEC. 2032. REPEAL OF LIMITED SCOPE AUDIT.

(a) IN GENERAL.—Section 103(a)(3) (29 U.S.C. 1023(a)(3)) is amended by striking subparagraph (C) and by redesignating subparagraph (D) as subparagraph (C).

(b) CONFORMING AMENDMENTS.—

(1) Section 103(a)(3)(A) (29 U.S.C. 1023(a)(3)(A)) is amended by striking "Except as provided in subparagraph (C), the" and inserting "The".

(2) Section 104(a)(5)(A) (29 U.S.C. 1024(a)(5)(A)) is amended by striking "section 103(a)(3)(D)" and inserting "section 103(a)(3)(C)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to opinions required under section 103(a)(3)(A) of the Employee Retirement Income Security Act of 1974 for plan years beginning on or after January 1 of the calendar year following the date of the enactment of this Act.

SEC. 2033. REPORTING AND ENFORCEMENT REQUIREMENTS FOR EMPLOYEE BENEFIT PLANS.

(a) IN GENERAL.—Part 1 of subtitle B of title I (29 U.S.C. 1021 et seq.) is amended—

(1) by redesignating section 111 as section 112, and

(2) by inserting after section 110 the following new section:

"DIRECT REPORTING OF CERTAIN EVENTS

"SEC. 111. (a) REQUIRED NOTIFICATIONS.—

"(1) NOTIFICATIONS BY PLAN ADMINISTRATOR.—The administrator of an employee benefit plan shall, within 5 business days after the administrator determines that there is evidence (or after the administrator is notified under paragraph (2)) that an irregularity may have occurred with respect to the plan—

"(A) notify the Secretary of the irregularity in writing; and

"(B) furnish a copy of such notification to the accountant who is currently engaged under section 103(a)(3)(A).

"(2) NOTIFICATIONS BY ACCOUNTANT.—

"(A) IN GENERAL.—An accountant engaged by the administrator of an employee benefit plan under section 103(a)(3)(A) shall, with-

in 5 business days after the accountant in connection with such engagement determines that there is evidence that an irregularity may have occurred with respect to the plan—

"(i) notify the plan administrator of the irregularity in writing, or

"(ii) if the accountant determines that there is evidence that the irregularity may have involved an individual who is the plan administrator or who is a senior official of the plan administrator, notify the Secretary of the irregularity in writing.

"(B) NOTIFICATION UPON FAILURE OF PLAN ADMINISTRATOR TO NOTIFY.—If an accountant who has provided notification to the plan administrator pursuant to subparagraph (A)(i) does not receive a copy of the administrator's notification to the Secretary required under paragraph (1)(B) within the 5-business day period specified therein, the accountant shall furnish to the Secretary a copy of the accountant's notification made to the plan administrator on the next business day following such period.

"(3) IRREGULARITY DEFINED.—

"(A) For purposes of this subsection, the term 'irregularity' means—

"(i) a theft, embezzlement, or a violation of section 664 of title 18, United States Code (relating to theft or embezzlement from an employee benefit plan);

"(ii) an extortion or a violation of section 1951 of such title 18 (relating to interference with commerce by threats or violence);

"(iii) a bribery, a kickback, or a violation of section 1954 of such title 18 (relating to offer, acceptance, or solicitation to influence operations of an employee benefit plan);

"(iv) a violation of section 1027 of such title 18 (relating to false statements and concealment of facts in relation to employer benefit plan records); or

"(v) a violation of section 411, 501, or 511 of this title (relating to criminal violations).

"(B) The term 'irregularity' shall not include any act or omission described in this paragraph involving less than $1,000 unless

there is reason to believe that the act or omission may bear on the integrity of plan management.

"(b) NOTIFICATION UPON TERMINATION OF ENGAGEMENT OF ACCOUNTANT.—

"(1) NOTIFICATION BY PLAN ADMINISTRATOR.—Within 5 business days after the termination of an engagement for auditing services under section 103(a)(3)(A) with respect to an employee benefit plan, the administrator of such plan shall—

"(A) notify the Secretary in writing of such termination, giving the reasons for such termination, and

"(B) furnish the accountant whose engagement was terminated with a copy of the notification sent to the Secretary.

"(2) NOTIFICATION BY ACCOUNTANT.—If the accountant referred to in paragraph (1)(B) has not received a copy of the administrator's notification to the Secretary as required under paragraph (1)(B), or if the accountant disagrees with the reasons given in the notification of termination of the engagement for auditing services, the accountant shall notify the Secretary in writing of the termination, giving the

reasons for the termination, within 10 business days after the termination of the engagement.

"(c) DETERMINATION OF PERIODS REQUIRED FOR NOTIFICATION.—In determining whether a notification required under this section with respect to any act or omission has been made within the required number of business days—

"(1) the day on which such act or omission begins shall not be included; and

"(2) Saturdays, Sundays, and legal holidays shall not be included.

For purposes of this subsection, the term 'legal holiday' means any Federal legal holiday and any other day appointed as a holiday by the State in which the person responsible for making the notification principally conducts his business.

"(d) IMMUNITY FOR GOOD FAITH NOTIFICATION.—Except as provided in this Act, no accountant or plan administrator shall be liable to any person for any finding, conclusion, or statement made in any notification made pursuant to subsection (a)(2) or (b)(2), or pursuant to any regulations issued thereunder, if such finding, conclusion, or statement is made in good faith."

(b) CIVIL PENALTY.—

(1) IN GENERAL.—Section 502(c) (29 U.S.C. 1132(c)), as amended by section 2002, is amended by redesignating paragraph (6) as paragraph (7) and by inserting after paragraph (5) the following new paragraph:

"(6)(A) The Secretary may assess a civil penalty of up to $100,000 against any administrator who fails to provide the Secretary with any notification as required under section 111.

"(B) The Secretary may assess a civil penalty of up to $100,000 against any accountant who knowingly and willfully fails to provide the Secretary with any notification as required under section 111."

(2) CONFORMING AMENDMENT.—Section 502(a)(6) (29 U.S.C. 1132(a)(6)), as amended by section 2002, is amended by striking "or (5)" and inserting "(5), or (6)".

(c) CLERICAL AMENDMENTS.—

(1) Section 514(d) (29 U.S.C. 1144(d)) is amended by striking "111" and inserting "112".

(2) The table of contents in section 1 is amended by striking the item relating to section 111 and inserting the following new items:

"Sec. 111. Direct reporting of certain events.
"Sec. 112. Repeal and effective date."

(d) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to any irregularity or termination of engagement described in such amendments only if the 5-day period described in such amendments in connection with such irregularity or termination commences at least 90 days after the date of the enactment of this Act.

SEC. 2034. ADDITIONAL REQUIREMENTS FOR QUALIFIED PUBLIC ACCOUNTANTS.

(a) IN GENERAL.—Section 103(a)(3)(C) (29 U.S.C. 1023(a)(3)(C)), as redesignated by section 2032, is amended—

(1) by inserting "(i)" after "(C)";

(2) by inserting ", with respect to any engagement of an accountant under subparagraph (A)" after "means";

(3) by redesignating clauses (i), (ii), and (iii) as subclauses (I), (II), and (III), respectively;

(4) by striking the period at the end of subclause (III) (as so redesignated) and inserting a comma;

(5) by adding after subclause (III) (as so redesignated), and flush with clause (i), the following: "but only if such person meets the requirements of clauses (ii) and (iii) with respect to such engagement."; and

(6) by adding at the end the following new clauses:

"(ii) A person meets the requirements of this clause with respect to an engagement of such person as an accountant under subparagraph (A) if such person—

"(I) has in operation an appropriate internal quality control system;

"(II) has undergone a qualified external quality control review of the person's accounting and auditing practices, including such practices relevant to employee benefit plans (if any), during the 3-year period immediately preceding such engagement; and

"(III) has completed, within the 2-year period immediately preceding such engagement, at least 80 hours of continuing education or training which contributes to the accountant's professional proficiency, at least 20 hours of which have been completed during the 1-year period immediately preceding the engagement, and at least 16 hours of which relate to employee benefit plan matters.

"(iii) A person meets the requirements of this clause with respect to an engagement of such person as an accountant under subparagraph (A) if such person meets such additional requirements and qualifications of regula-

tions which the Secretary deems necessary to ensure the quality of plan audits.

"(iv) For purposes of clause (ii)(II), an external quality control review shall be treated as qualified with respect to a person referred to in clause (ii) if—

"(I) such review is performed in accordance with the requirements of external quality control review programs of recognized auditing standard-setting bodies, as determined under regulations of the Secretary, and

"(II) in the case of any such person who has, during the peer review period, conducted one or more previous audits of employee benefit plans, such review includes the review of an appropriate number (determined as provided in such regulations, but in no case less than one) of plan audits in relation to the scale of such person's auditing practice.

The Secretary shall issue the regulations under subclause (I) no later than December 31, 1997."

(b) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply with respect to plan years beginning on or after the date which is 3 years after the date of the enactment of this Act.

(2) RESTRICTIONS ON CONDUCTING EXAMINATIONS.—Clause (iii) of section 103(a)(3)(C) of the Employee Retirement Income Security Act of 1974 (as added by subsection (a)(6)) shall take effect on the date of enactment of this Act.

SEC. 2035. CLARIFICATION OF FIDUCIARY PENALTIES.

(a) MODIFICATION OF PROHIBITION OF ASSIGNMENT OR ALIENATION.—

(1) AMENDMENT TO ERISA.—Section 206(d) (29 U.S.C. 1056(d)) is amended by adding at the end the following new paragraphs:

"(4) Paragraph (1) shall not apply to any offset of a participant's accrued benefit in an employee pension benefit plan against an amount that the participant is ordered or required to pay to the plan if—

"(A) the order or requirement to pay arises–

"(i) under a judgment of conviction for a crime involving such plan,

"(ii) under a civil judgment (including a consent order or decree) entered by a court in an action brought in connection with a violation (or alleged violation) of part 4 of this subtitle, or

"(iii) pursuant to a settlement agreement between the Secretary and the participant, or a

settlement agreement between the Pension Benefit Guaranty Corporation and the participant, in connection with a violation (or alleged violation) of part 4 of this subtitle,

"(B) the judgment, order, decree, or settlement agreement expressly provides for the offset of all or part of the amount ordered or required to be paid to the plan against the participant's accrued benefit in the plan, and

"(C) if the participant has a spouse at the time at which the offset is to be made—

"(i) such spouse has consented in writing to such offset and such consent is witnessed by a notary public or representative of the plan,

"(ii) such spouse is ordered or required in such judgment, order, decree, or settlement to pay an amount to the plan in connection with a violation of part 4 of this title, or

"(iii) in such judgment, order, decree, or settlement, such spouse retains the right to receive the value of the survivor annuity under a qualified joint and survivor annuity provided pursuant to section 205(a)(1) and under a qualified preretirement survivor annuity pro-

vided pursuant to section 205(a)(2), determined in accordance with paragraph (5).

"(5)(A) The value of the survivor annuity described in paragraph (4)(C)(iii) shall be determined as if—

"(i) the participant terminated employment on the date of the offset,

"(ii) there was no offset,

"(iii) the plan permitted retirement only on or after normal retirement age,

"(iv) the plan provided only the minimum-required qualified joint and survivor annuity, and

"(v) the amount of the qualified preretirement survivor annuity under the plan is equal to the amount of the survivor annuity payable under the minimum-required qualified joint and survivor annuity.

"(B) For purposes of this paragraph, the term 'minimum-required qualified joint and survivor annuity' means the qualified joint and survivor annuity which is the actuarial equivalent of a single annuity for the life of the participant and under which the survivor annuity is 50 percent of the amount of the annuity which is payable during the joint lives of the participant and the spouse."

(2) EFFECTIVE DATE.—The amendment made by this subsection shall apply to judgments, orders,

and decrees issued, and settlement agreements entered into, on or after the date of enactment of this Act.

(b) CIVIL PENALTIES FOR BREACH OF FIDUCIARY RESPONSIBILITY.—

(1) IMPOSITION AND AMOUNT OF PENALTY MADE DISCRETIONARY.—Section 502(l)(1) (29 U.S.C. 1132(l)(1)) is amended—

(A) by striking "shall" and inserting "may", and

(B) by striking "equal to" and inserting "not greater than".

(2) APPLICABLE RECOVERY AMOUNT.—Section 502(l)(2) (29 U.S.C. 1132(l)(2)) is amended to read as follows:

"(2) For purposes of paragraph (1), the term 'applicable recovery amount' means any amount which is recovered from (or on behalf of) any fiduciary or other person with respect to a breach or violation described in paragraph (1) on or after the 30th day following receipt by such fiduciary or other person of written notice from the Secretary of the violation, whether paid voluntarily or by order of a court in a judicial proceeding instituted by the Secretary under subsection (a)(2) or (a)(5). The Secretary

may, in the Secretary's sole discretion, extend the 30-day period described in the preceding sentence."

(3) OTHER RULES.—Section 502(l) (29 U.S.C. 1132(l)) is amended by adding at the end the following new paragraphs:

"(5) A person shall be jointly and severally liable for the penalty described in paragraph (1) to the same extent that such person is jointly and severally liable for the applicable recovery amount on which the penalty is based.

"(6) No penalty shall be assessed under this subsection unless the person against whom the penalty is assessed is given notice and opportunity for a hearing with respect to the violation and applicable recovery amount."

(4) EFFECTIVE DATES.—

(A) IN GENERAL.—The amendments made by this subsection shall apply to any breach of fiduciary responsibility or other violation of part 4 of subtitle B of title I of the Employee Retirement Income Security Act of 1974 occurring on or after the date of enactment of this Act.

(B) TRANSITION RULE.—In applying the amendment made by paragraph (2) (relating to applicable recovery amount), a breach or other violation occurring before the date of the enactment of this Act which continues after the

180th day after such date (and which may have been discontinued at any time during its existence) shall be treated as having occurred after such date of enactment.

TITLE III—ADDITIONAL RETIREMENT PARTICIPATION AND PAYMENT OPTIONS FOR FEDERAL EMPLOYEES

SEC. 3001. IMMEDIATE PARTICIPATION IN THE THRIFT SAVINGS PLAN FOR FEDERAL EMPLOYEES.

(a) ELIMINATION OF CERTAIN WAITING PERIODS FOR PURPOSES OF EMPLOYEE CONTRIBUTIONS.—Paragraph (4) of section 8432(b) of title 5, United States Code, is amended to read as follows:

"(4) The Executive Director shall prescribe such regulations as may be necessary to carry out the following:

"(A) Notwithstanding subparagraph (A) of paragraph (2), an employee or Member described in such subparagraph shall be afforded a reasonable opportunity to first make an election under this subsection beginning on the date of commencing service or, if that is not administratively feasible, beginning on the earliest date thereafter that such an election becomes administratively feasible, as determined by the Executive Director.

"(B) An employee or Member described in subparagraph (B) of paragraph (2) shall be afforded a reasonable opportunity to first make an election under this subsection (based on the appointment or election described in such subparagraph) beginning on the date of commencing service pursuant to such appointment or election or, if that is not administratively feasible, beginning on the earliest date thereafter that such an election becomes administratively feasible, as determined by the Executive Director.

"(C) Notwithstanding the preceding provisions of this paragraph, contributions under paragraphs (1) and (2) of subsection (c) shall not be payable with respect to any pay period before the earliest pay period for which such contributions would otherwise be allowable under this subsection if this paragraph had not been enacted.

"(D) Sections 8351(a)(2), 8440a(a)(2), 8440b(a)(2), 8440c(a)(2), and 8440d(a)(2) shall be applied in a manner consistent with the purposes of subparagraphs (A) and (B), to the extent those subparagraphs can be applied with respect thereto.

"(E) Nothing in this paragraph shall affect paragraph (3).".

(b) TECHNICAL AND CONFORMING AMENDMENTS.—(1) Section 8432(a) of title 5, United States Code, is amended—

(A) in the first sentence by striking "(b)(1)" and inserting "(b)"; and

(B) by amending the second sentence to read as follows: "Contributions under this subsection pursuant to such an election shall, with respect to each pay period for which such election remains in effect, be made in accordance with a program of regular contributions provided in regulations prescribed by the Executive Director.".

(2) Section 8432(b)(1)(B) of such title is amended by inserting "(or any election allowable by virtue of paragraph (4))" after "subparagraph (A)".

(3) Section 8432(b)(3) of such title is amended by striking "Notwithstanding paragraph (2)(A), an" and inserting "An".

(4) Section 8432(i)(1)(B)(ii) of such title is amended by striking "either elected to terminate individual contributions to the Thrift Savings Fund within 2 months before commencing military service or".

(5) Section 8439(a)(1) of such title is amended by inserting "who makes contributions or" after "for each

individual" and by striking "section 8432(c)(1)" and inserting "section 8432".

(6) Section 8439(c)(2) of such title is amended by adding at the end the following: "Nothing in this paragraph shall be considered to limit the dissemination of information only to the times required under the preceding sentence.".

(7) Sections 8440a(a)(2) and 8440d(a)(2) of such title are amended by striking all after "subject to" and inserting "subject to this chapter.".

(c) EFFECTIVE DATE.—This section shall take effect 6 months after the date of the enactment of this Act or such earlier date as the Executive Director may by regulation prescribe.

SEC. 3002. DEFERRED ANNUITIES FOR SURVIVING SPOUSES OF FEDERAL EMPLOYEES.

(a) IN GENERAL.—Section 8341 of title 5, United States Code, is amended—

(1) in subsection (h)(1) by striking "section 8338(b) of this title" and inserting "section 8338(b), and a former spouse of a deceased former employee who separated from the service with title to a deferred annuity under section 8338 (if they were married to one another prior to the date of separation),"; and

(2) by adding at the end the following:

"(j)(1) If a former employee dies after having separated from the service with title to a deferred annuity under section 8338 but before having established a valid claim for annuity, and is survived by a spouse to whom married on the date of separation, the surviving spouse may elect to receive—

"(A) an annuity, commencing on what would have been the former employee's 62d birthday, equal to 55 percent of the former employee's deferred annuity;

"(B) an annuity, commencing on the day after the date of death of the former employee, such that, to the extent practicable, the present value of the future payments of the annuity would be actuarially equivalent to the present value of the future payments under subparagraph (A) as of the day after the former employee's death; or

"(C) the lump-sum credit, if the surviving spouse is the individual who would be entitled to the lump-sum credit and if such surviving spouse files application therefor.

"(2) An annuity under this subsection and the right thereto terminate on the last day of the month before the

surviving spouse remarries before becoming 55 years of age, or dies.".

(b) CORRESPONDING AMENDMENT FOR FERS.—Section 8445(a) of title 5, United States Code, is amended—

(1) by striking "(or of a former employee or" and inserting "(or of a former"; and

(2) by striking "annuity)" and inserting "annuity, or of a former employee who dies after having separated from the service with title to a deferred annuity under section 8413 but before having established a valid claim for annuity (if such former spouse was married to such former employee prior to the date of separation))".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to surviving spouses and former spouses (whose marriage, in the case of the amendments made by subsection (a), terminated after May 6, 1985) of former employees who die after the date of the enactment of this Act.

SEC. 3003. PAYMENT OF LUMP-SUM CREDIT FOR FORMER SPOUSES OF FEDERAL EMPLOYEES.

(a) IN GENERAL.—Title 5, United States Code, is amended—

(1) in section 8342(c) by striking "Lump-sum" and inserting "Except as provided in section 8345(j), lump-sum";

(2) in section 8345(j)—

(A) in paragraph (1) by inserting after "that individual" the following: ", or be made under section 8342(d) through (f) to an individual entitled under section 8342(c),"; and

(B) by adding at the end the following:

"(4) Any payment under this subsection to a person bars recovery by any other person.";

(3) in section 8424(d) by striking "Lump-sum" and inserting "Except as provided in section 8467(a), lump-sum"; and

(4) in section 8467—

(A) in subsection (a) by inserting after "that individual" the following: ", or be made under section 8424(e) through (g) to an individual entitled under section 8424(d),"; and

(B) by adding at the end the following:

"(d) Any payment under this section to a person bars recovery by any other person.".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to any death occurring

after the 90th day after the date of the enactment of this Act.

TITLE IV—CONFORMING RAILROAD RETIREMENT BENEFITS WITH SOCIAL SECURITY

SEC. 4001. CHILD'S ANNUITY.

(a) ELIGIBILITY FOR ANNUITY.—Section 2 of the Railroad Retirement Act of 1974 is amended by adding at the end the following new subsection:

"(i) The child (as defined in section 216(e) and (k) of the Social Security Act) of an individual, if—

"(i)(I) such child will be less than 18 years of age,

"(II) such child will be less than 19 years of age and a full-time elementary or secondary school student, or

"(III) such child will, without regard to his or her age, be under a disability which began before the child attained age 22 or before the 84th month following the month in which his most recent entitlement to an annuity under this subsection terminated because he or she ceased to be under a disability, and

"(ii) such child is unmarried and dependent upon the employee,

shall be entitled to an annuity, if he or she has filed an application therefor, in the amount provided under section 4 of this Act."

(b) AMOUNT OF ANNUITY.—Section 4 of such Act is amended—

(1) in the heading, by adding at the end "AND CHILD ANNUITIES"; and

(2) by adding at the end the following new subsection:

"(j) The annuity of a child of an individual under section 2(i) of this Act shall be in the amount that would have been payable to the child under title II of the Social Security Act if all of the individual's service after December 31, 1936, had been included in the term 'employment' as defined in that Act reduced by any benefit payable under title II of the Social Security Act.".

(c) TECHNICAL AMENDMENT.—The first sentence of section 3(f)(3) of such Act is amended by striking "the spouse and divorced wife" and inserting "the spouse, child, and divorced wife".

SEC. 4002. ENTITLEMENT TO SPOUSAL ANNUITIES.

(a) ENTITLEMENT DESPITE CERTAIN AGE REQUIREMENTS.—Section 2(c)(1) of the Railroad Retirement Act of 1974 is amended by adding at the end the following: "A spouse who is not entitled to an annuity by reason

of paragraph (i)(B) of this subdivision, but who otherwise meets the conditions for entitlement to an annuity under this subsection, shall be entitled to an annuity in such amount as would have been payable under title II of the Social Security Act if all of the individual's service after December 31, 1936, had been included in the term 'employment' as defined in that Act reduced by any benefit payable to the spouse under title II of the Social Security Act.".

(b) REMOVAL OF AGE REQUIREMENT FOR DIVORCED SPOUSES.—Section 2(c)(4) of such Act is amended by striking paragraph (ii), by redesignating paragraph (iii) as paragraph (ii), and by striking paragraph (i) and inserting the following:

"(i) such individual has completed 10 years of service; and".

(c) ENTITLEMENT OF DIVORCED SPOUSE WHERE WORKER'S ANNUITY IS NOT PAYABLE.—Section 2(e)(5) of such Act is amended by striking "or divorced wife" in the second sentence.

SEC. 4003. CONTINUED PAYMENT TO SURVIVORS OF WAIVED LUMP SUM BENEFITS IN AMOUNTS EQUIVALENT TO SOCIAL SECURITY SURVIVOR BENEFITS

Section 6(c)(1) of the Railroad Retirement Act of 1974 is amended by striking all that follows "*Provided*, however," and inserting the following: "That if the employee is survived by a widow, widower, or parent who may upon attaining the age of eligibility be entitled to benefits under this Act, such lump sum shall not be paid unless such widow, widower, or parent makes and files with the Board an irrevocable election, in such form as the Board may prescribe, to have such lump sum be paid in lieu of all benefits, other than the amount of the benefits that the widow, widower, or parent would have received under title II of the Social Security Act if all of the employee's service after December 31, 1936, had been included in the term 'employment' as defined in that Act. After a lump sum with respect to the death of an employee is paid pursuant to an election filed with the Board under the provisions of this subsection, no further benefits, other than benefits in such amounts as would have been payable under title II of the Social Security Act if all of the employee's service after December 31, 1936, had been included in the term 'employment' as defined in that Act.

shall be paid under this Act on the basis of such employee's compensation and service under this Act.".

SEC. 4004. LUMP SUM DEATH BENEFITS EQUIVALENT TO SOCIAL SECURITY BENEFITS.

(a) IN GENERAL.—Section 6(b)(2) of the Railroad Retirement Act of 1974 is amended to read as follows:

"(2) Upon the death of an individual who (A) will have completed ten years of service at the time of his death, and (B) will have had a current connection with the railroad industry at the time of his death, a lump-sum death payment shall be made in accordance with the provisions of section 202(i) of the Social Security Act in an amount equal to the amount which would have been payable under such section 202(i) if such individual's service as an employee after December 31, 1936, were included in the term 'employment' as defined in that Act.".

(b) CONFORMING AMENDMENT.—Section 6(b)(1) of such Act is amended by inserting before the period at the end of the first sentence the following: "less any lump-sum benefit payable under subdivision (2) of this subsection".

SEC. 4005. PAYMENT OF BENEFITS EQUIVALENT TO SOCIAL SECURITY BENEFITS WITH RESPECT TO SERVICE FOR WHICH CERTAIN RAILROAD RETIREMENT ANNUITIES ARE NOT PAYABLE.

Section 2(e) of the Railroad Retirement Act of 1974 is amended by adding at the end the following new subdivision:

"(6) A person who has filed an application for an annuity under this Act, but whose annuity is not payable for a month by reason of subdivision (1), (3), or (5) of this subsection and who is entitled to a benefit under title II of the Social Security Act for such month shall be entitled to receive an annuity under this Act for such month equal to the difference between the benefit under such title II paid for such month and the benefit under such title II that would have been paid for such month if all of the individual's service after December 31, 1936, had been included in the term 'employment' as defined in that Act.".

SEC. 4006. EFFECTIVE DATE.

The amendments made by this title shall take effect on January 1, 1997.

General Explanation
of the
Retirement Savings and Security Act

Department of the Treasury
Department of Labor
Office of Personnel Management
May 1996

Table of Contents

TITLE I -- REVENUE PROVISIONS

SUBTITLE A -- EXPANDED PENSION COVERAGE AND SIMPLIFICATION

CHAPTER 1 -- THE NEST AND OTHER COVERAGE EXPANSION

CHAPTER 2 -- SIMPLIFICATION AND COST SAVINGS

TITLE I -- REVENUE PROVISIONS
SUBTITLE A -- EXPANDED PENSION COVERAGE AND SIMPLIFICATION
CHAPTER 1 -- THE NEST AND OTHER COVERAGE EXPANSION

THE NEST -- A SIMPLE RETIREMENT PLAN FOR SMALL BUSINESS
(Section 1101)

Current Law

Under current law, an individual may make deductible contributions to an individual retirement account or individual retirement annuity (IRA) up to the lesser of $2,000 or compensation (wages and self-employment income). (The dollar limit is $2,250 if the individual's spouse has no compensation.) If the individual (or the individual's spouse) is an active participant in an employer-sponsored retirement plan, the $2,000 limit on deductible contributions is phased out for couples filing a joint return with adjusted gross income (AGI) between $40,000 and $50,000, and for single taxpayers with AGI between $25,000 and $35,000. To the extent that an individual is not eligible for deductible IRA contributions, he or she may make nondeductible IRA contributions (up to the contribution limit).

The earnings on IRA account balances are not included in income until they are withdrawn. Withdrawals from an IRA (other than withdrawals of nondeductible contributions) are includible in income, and must begin by age 70 ½. Amounts withdrawn before age 59 ½ are generally subject to an additional 10 percent tax. The additional tax does not apply to distributions upon the death or disability of the taxpayer or to substantially equal periodic payments over the life (or life expectancy) of the IRA owner or over the joint lives (or life expectancies) of the IRA owner and his or her beneficiary.

Simplified employee pensions (SEPs) and, for employers with 25 or fewer employees, salary reduction SEPs (SARSEPs), are employer-sponsored plans under which employer contributions and, in the case of SARSEPs, employee-elected salary reduction contributions are made to IRAs established by employees. An employer that adopts a SEP must contribute to the SEP for every employee who has attained age 21, has worked for the employer during at least three of the immediately preceding five years, and is paid at least $400 (for 1996, as adjusted for cost of living) by the employer for the year. Thus, for example, an employer would have to make a SEP contribution for an employee who worked for the employer one hour per year in the preceding three years and worked 40 hours (and earned $400) in the current year, if the employer was making contributions for any other employee for the year. SEPs do not allow employees to make elective contributions through salary reduction.

SARSEPs allow employees to make elective contributions, but cannot provide for employer matching contributions. SARSEPs are available only to for-profit employers that had 25 or fewer employees at all times during the preceding year. In addition, special eligibility and nondiscrimination rules apply to SARSEPs. If at least 50 percent of the eligible employees do not choose to make elective contributions to a SARSEP in a year, then no employee can make elective contributions. An employer with 25 or fewer employees may fall below the 50 percent threshold (and out of SARSEP eligibility) from year to year.

SARSEPs are subject to the top-heavy rules. A SARSEP is considered top-heavy if the aggregate accounts of key employees in the plan exceed 60 percent of the aggregate accounts of all employees in the plan. If a SARSEP is top-heavy and any key employee of the employer makes elective contributions of at least 3 percent of pay, then the employer must make minimum contributions of 3 percent of pay for all non-key employees -- even if those non-key employees also make elective contributions of 3 percent of pay.

Reasons for Change

The tax-favored employer retirement plans currently available under the Internal Revenue Code have not been sufficiently successful in attracting small employers. In 1993, for example, only 24 percent of full-time workers in private firms with fewer than 100 employees were covered by employer retirement plans. In contrast, 73 percent of full-time workers in firms with 1,000 or more workers were covered.

The administrative cost and complexity associated with traditional qualified retirement plans often discourage small employers from sponsoring these plans. For employers with few employees, the cost of maintaining the plan may be large relative to the benefits provided to employees. As a result, pension coverage of employees of small employers is significantly lower than the pension coverage of employees of larger employers.

SEPs and SARSEPs, which were designed for small employers, are perceived by many employers as overly complicated and impractical. The nondiscrimination and eligibility rules applicable to SARSEPs make it difficult for an eligible employer to maintain a SARSEP on an ongoing basis. An eligible employer cannot encourage employees to make elective contributions through the incentive of offering to match employee contributions dollar-for-dollar or otherwise.

The inability to offer matching contributions makes it difficult for the employer to satisfy the SARSEP nondiscrimination test. Under this test, elective contributions for any highly compensated employee are limited to 125 percent of the average elective contributions for all nonhighly compensated employees for the year. Thus, highly compensated employees are limited to very low levels of elective contributions unless other employees make significant elective contributions -- which they are less likely to make without the incentive of a matching contribution. Concerns have also been raised that, where SEPs and SARSEPs are used, there may be significant noncompliance with the statutory requirements.

Proposal

The proposal would allow employers with 100 or fewer employees to adopt a new simple retirement plan. The new plan would be known as the National Employee Savings Trust, or "NEST."

The NEST would operate through individual IRA accounts for employees, and would incorporate design-based nondiscrimination safe harbors similar to those the Administration is proposing for 401(k) plans. Like other IRA accounts, investment in NEST accounts would be directed by each employee. By eliminating or greatly simplifying many of the rules that apply to other qualified retirement plans, including 401(k) plans, the NEST would remove major obstacles that deter

many small employers from setting up retirement plans. The current SEP and SARSEP rules would not be eliminated or modified, but would remain in place.

Funding Through IRAs

Use of IRAs as the funding vehicle. All employee and employer contributions to NESTs would be made to IRAs, and the IRA rules would govern except where otherwise specified.

Initial use of specific financial institution. In order to simplify plan administration for employers, an employer could require that all of its participating employees use a designated financial institution's IRAs as the recipient of NEST contributions -- but only if participants were notified in writing that a participant could move his or her account balance (in a trustee-to-trustee transfer) without charge to another IRA at any time. This notification could be incorporated into the annual disclosure to employees regarding the NEST (described below) or could be provided separately.

Employer Eligibility

100-employee limit. Any employer, including a tax-exempt organization or governmental entity, would be eligible to make a NEST program available to its employees in a given year if the employer had no more than 100 employees in the prior year. For this purpose, employees would be counted only if they had at least $5,000 of compensation (as reported on Form W-2) from the employer. The "employer" would be determined on a "controlled group" basis (i.e., aggregating 80 percent affiliates).

Two-year grace period. If an eligible employer established a NEST program and, subsequently, the number of employees grew to exceed 100 (based on the prior year's employment), the employer would continue to be eligible to provide a NEST for the current and subsequent year. After that two-year "grace period," the employer would cease to be eligible unless the employee count again dropped to 100 or fewer (based on the prior year's employment). If an eligible employer ceased to meet the 100-employee test because of an acquisition, disposition or similar transaction, the NEST program could continue for the grace period only if no significant changes in coverage occurred.

Employee Eligibility to Participate and Vesting

Two-year eligibility. Each employee who attained age 21 and completed two consecutive years of service with the employer generally would be eligible to participate in the NEST. A "year of service" would be defined as a calendar year during which an employee's W-2 compensation from the employer was at least $5,000. An employer could choose to allow all employees to participate earlier than upon attainment of age 21 and completion of two years of service. Nonresident aliens and employees covered under a collective bargaining agreement would not have to be eligible to participate in a NEST.

Participating employees who drop below the $5,000 threshold or whose employment terminates mid-year. Once an employee became eligible, the employee would be entitled to make elective contributions and receive any employer matching contributions for a year without regard to

the employee's compensation during the year. All eligible employees with at least $5,000 of compensation[1] from the employer for the year would receive a nonelective employer contribution for that year. However, no nonelective employer contributions would be required for eligible employees with less than $5,000 of compensation for the year, unless the employer chose a lower compensation threshold for all eligible employees.

Portability/100 percent vesting. All contributions would be 100 percent vested immediately and would be fully portable, even during the two-year holding period (described below).

No Nondiscrimination Testing

Nondiscrimination tests not applicable. NESTs would not be subject to:

- the top-heavy rules;
- the nondiscrimination rules that apply to elective contributions under a 401(k) plan (the "ADP" test);
- the nondiscrimination rules that apply to matching contributions (the "ACP" test); or
- the nondiscrimination rules that apply to SEPs and SARSEPs. (Thus, for example there would be no 50 percent participation requirement, and no 125 percent test.)

HCE determinations irrelevant. Because NESTs would not be subject to any nondiscrimination tests, an employer that offers a NEST would not be required to determine which employees are "highly compensated employees."

Contributions

NESTs would receive nonelective employer contributions and, depending on the option selected by the employer, elective contributions and employer matching contributions.

Design-based safe harbors. In lieu of top-heavy and nondiscrimination rules, every NEST would be required to choose annually to satisfy one of the following two design-based safe harbors (generally similar to the Administration's proposed 401(k) safe harbors):

(1) The employer makes a nonelective contribution of at least 3 percent of compensation[2] for each eligible employee. The employer may choose to allow employee elective contributions

---

[1]Any employee elective contributions to the NEST would be included in compensation for this purpose.

[2] The $150,0000 compensation limit that applies for purposes of the deduction and contribution limits for qualified plans, SEPs and SARSEPs would also apply for purposes of the NEST contributions.

in addition to the employer nonelective contributions (an employer who wants to combine nonelective contributions with matching contributions may use the second safe harbor).

(2) The employer makes a nonelective contribution of at least 1 percent of compensation for each eligible employee and allows employee elective contributions. The employer must provide a 100 percent matching contribution on the employees' elective contributions up to 3 percent of compensation and a matching contribution of at least 50 percent (and no greater than 100 percent) on the next 2 percent of employees' elective contributions. The employer may not provide any other matching formula, including a more generous formula. Although this safe harbor would require a 1 percent nonelective employer contribution, the top-heavy rules would not apply, as noted above. This means that those employers that otherwise would have been required to make a 3 percent top-heavy minimum contribution for each non-key employee would have to make only a 1 percent nonelective contribution. In addition, employers that offer a NEST would be relieved of the requirement to test the NEST for top-heavy status.

Employee elective contributions. The limit on an employee's annual elective contributions (i.e., salary reduction contributions) to a NEST would be $5,000. (Elective contributions to 401(k) plans are currently limited to $9,500.) The NEST limit would remain at $5,000 until the section 402(g) limit exceeded $10,000; then, the NEST limit would be indexed to (and remain at) one half of the section 402(g) limit for each year.

Nonelective employer contributions. A NEST could provide for discretionary nonelective employer contributions in excess of the safe harbor minimums (1 percent or 3 percent) from year to year. Any such nonelective employer contributions in excess of the 1 percent or 3 percent minimums would have to be an equal percentage of compensation for all eligible employees. Total nonelective contributions (both the safe harbor minimums and discretionary contributions) could not exceed 5 percent of compensation.

Section 404 deduction limit not applicable. The employer would be permitted to deduct the elective, matching, and nonelective contributions described above (within the contribution limits described) without regard to any separate percent-of-compensation limitation (i.e., there would be no limit comparable to that imposed by section 404(a)(3)).

Timing of Contributions

Elective contributions. Employee elective contributions would be required to be deposited in employees' accounts by the time required under Title I of ERISA for elective contributions to a 401(k) plan.

Quarterly employer contributions. Employer matching contributions would be required to be deposited in employees' accounts (IRAs) no less frequently than quarterly. Employer nonelective contributions would also be required to be deposited no less frequently than quarterly -- but only for employees who as of the end of the quarter were paid at least $5,000 (or any lower threshold adopted by the employer) for that calendar year. If an employee did not reach the threshold until the second, third, or fourth calendar quarter, the employer would be required, after the threshold had been

reached, to make nonelective contributions for both the current and all preceding calendar quarters in the year. Contributions for any calendar quarter would be required to be deposited within 45 days after the end of that quarter.

Distributions

Two-year holding period. NEST contributions (and attributable earnings) would be subject to a two-year holding period beginning on the first day of the calendar year for which the contribution was made. This two-year restriction on withdrawals would apply whether or not the participant had incurred a termination of employment.

In all other respects, distributions from NEST IRAs would be subject to the same rules as distributions from IRAs generally (as distinguished from 401(k) or other qualified plans) -- no other restrictions would be imposed. The additional 10 percent tax on premature distributions would apply to distributions before age 59 ½. During the two-year holding period, contributions and earnings could be rolled over to another IRA -- but the original two-year holding period would continue to apply to the rolled-over amounts in the recipient IRA.

Rollovers. NESTs could originate and receive transfers from other IRAs (whether NESTs, SEPs, SARSEPs, or other IRAs). NESTs could also receive rollovers from qualified plans. All movement of NEST funds to other IRAs, whether or not during the two-year holding period, would be required to be carried out in the form of a trustee-to-trustee transfer. Any amounts rolled over or transferred to a NEST would not be subject to the two-year holding period unless they were amounts transferred from a NEST for which the two-year holding period had not yet elapsed.

Miscellaneous

SEPs and other plans permitted. An employer that maintains a NEST could also maintain tax-qualified plans or SEPs, other than a plan that allows for elective contributions or matching contributions. For example, if the employer maintained a 401(k), salary reduction or matching 403(b), or SARSEP plan, and wished to establish a NEST, it would have to freeze (but not terminate) the 401(k), 403(b), or SARSEP plan.

If an employer did maintain another plan, compliance of the NEST with the NEST requirements would be determined without regard to the other plan. The other plan would have to take the NEST into account only for purposes of the section 404 deduction limits and the section 415 contribution and benefits limitations. For example, the top-heavy rules and nondiscrimination rules would apply to the other plan without regard to the NEST.

In the case of an employee who works for two employers, one of which sponsors a NEST and the other of which sponsors a 401(k), 403(b), or SARSEP plan, the section 402(g) elective deferral limit for that employee would be coordinated. Elective contributions to the NEST would have to be taken into account in determining whether the $9,500 limit had been exceeded under the other plan, but any elective contributions made to the other plan would not be taken into account in determining whether the $5,000 NEST limit had been exceeded.

Coordination with IRA deduction rules. NESTs would be treated as qualified plans for purposes of the IRA deduction phase-out rules. Thus, employees who participated in a NEST would be subject to the phase-out rules for making deductible IRA contributions if they had AGI in excess of the applicable thresholds.

IRS model form. The IRS would be directed to issue a model NEST document, but vendors and employers would have the option of using their own documents.

Application of ERISA fiduciary rules. Changes would also be made to ERISA to accommodate the NEST. Section 2001 of Title II of this Act would limit a plan sponsor's fiduciary liability. The sponsor would not be subject to fiduciary liability for the designation of the NEST trustee or issuer, or the manner in which the NEST is invested, after the earliest of (1) an affirmative employee election with respect to the initial investment of any contributions, (2) a transfer to another IRA, or (3) one year after the employee's NEST is established, provided that the employee had been properly notified that he or she has a right to transfer the NEST account balance without charge. The assets held in the NEST would cease to be plan assets when transferred to another IRA or otherwise distributed as benefits.

Reporting. ERISA would also be amended by section 2001 of Title II of this Act to make clear that an employer maintaining a NEST would not be subject to any reporting requirements (e.g., Form 5500 filing). However, the NEST trustee or issuer would be required to report NEST contributions on Form 5498, on which IRA contributions are reported.

Disclosure. Employees would be required to be notified annually in writing of their rights under the plan, including, for example, the right to a matching contribution and information from the NEST trustee or issuer. Similarly, if an employer wanted to change its safe harbor formula, the employer would be required to notify eligible employees of the formula that would be used for a year within a reasonable period of time before the beginning of the annual election period. (Employee elections to defer would occur in the last 60 days of each calendar year.)

Plan suspension. In order to provide flexibility to an employer that faced an unexpected financial hardship, employers would generally be permitted to suspend all NEST contributions (i.e., all elective, matching, and nonelective contributions) at any time during the year after notifying eligible employees in writing at least 30 days before the suspension. Only one suspension would be allowed during any year. The Secretary may prescribe rules to prevent abuse, such as the repeated suspension of a NEST in a manner that prevents seasonal workers from receiving benefits.

Calendar plan year. The calendar year would be the plan year for all NESTs and would have to be used in applying all NEST contribution limits, eligibility, and other NEST requirements.

This proposal would be effective for years beginning after December 31, 1996.

TAX-EXEMPT ORGANIZATIONS ELIGIBLE UNDER SECTION 401(k)
(Section 1102)

Current Law

Except for certain plans established before July 2, 1986, an organization exempt from income tax is not allowed to maintain a section 401(k) plan.

Reasons for Change

The limitation on maintaining a 401(k) plan prevents many tax-exempt organizations from offering their employees retirement benefits on a salary reduction basis. Although tax-sheltered annuity programs can provide similar benefits, many types of tax-exempt organizations are also precluded from offering those programs.

Proposal

The proposal would allow organizations exempt from income tax (other than state or local governments) and Indian tribes to maintain a 401(k) plan. This proposal would be effective for plan years beginning after December 31, 1996.

SIMPLIFIED NONDISCRIMINATION TESTING FOR 401(k) PLANS
(Section 1103)

Current Law

The actual deferral percentage (ADP) test generally applies to the elective contributions (typically made by salary reduction) of all employees eligible to participate in a 401(k) plan. The test requires the calculation of each eligible employee's elective contributions as a percentage of the employee's pay. The ADP test is satisfied if the plan passes either of the following two tests: (1) the average percentage of elective contributions for highly compensated employees does not exceed 125 percent of the average percentage of elective contributions for nonhighly compensated employees, or (2) the average percentage of elective contributions for highly compensated employees does not exceed 200 percent of the average percentage of elective contributions for nonhighly compensated employees, and does not exceed the percentage for nonhighly compensated employees by more than two percentage points. The actual contribution percentage (ACP) test is almost identical to the ADP test, but generally applies to employer matching contributions and after-tax employee contributions under any qualified employer retirement plan.

Both the ADP test and the ACP test generally compare the average contributions for highly compensated employees for the year to the average contributions for nonhighly compensated employees for the same year.

When the ADP or ACP test is violated, correction is made by reducing the excess contributions of highly compensated employees beginning with employees who have deferred the greatest percentage of pay.

Reasons for Change

The annual application of these tests, and correcting violations of these tests, can be complicated and costly. For example, because the current year average for the nonhighly compensated employees is not known until the end of the year, the tests commonly require either monitoring and adjustments of contributions over the course of the year or complicated correction procedures and information reporting after the end of the year.

The current correction method often does not affect the most highly paid of the highly compensated employees: their contributions, as a percentage of pay, are likely to be lower than the percentage contributions of lower-paid highly compensated employees, even if the dollar amount of their contributions is higher. For example, if an employee makes $85,000 and contributes $6,000 (7.05 percent of pay), his or her contribution would be reduced before that of a CEO who makes $150,000 and contributes $9,000 (6 percent of pay).

Proposal

Design-based safe harbors. The proposal would provide two alternative "design-based" safe harbors. If a plan were properly designed, the employer would avoid all ADP and ACP testing.

Under the first safe harbor, the employer would have to make nonelective contributions of at least 3 percent of compensation for each nonhighly compensated employee eligible to participate in the plan. Alternatively, under the second safe harbor, the employer would have to make a nonelective contribution of at least 1 percent of compensation for each eligible nonhighly compensated employee, a 100 percent matching contribution on an employee's elective contributions up to the first 3 percent of compensation, and a matching contribution of at least 50 percent on the employee's elective contributions up to the next 2 percent of compensation.

A more generous matching contribution formula would also be considered to satisfy the matching contribution safe harbor, but only if the level of matching contributions did not increase as employee elective contributions increased and the matching contributions at every level of compensation were at least as great as they would have been under the safe harbor formula. However, for purposes of satisfying the matching contribution safe harbor with respect to the ACP test (but not the ADP test), matching contributions could not be made with respect to employee elective contributions in excess of 6 percent of compensation. The safe harbors could not be used to satisfy the ACP test with respect to after-tax employee contributions, which would be tested separately.

Under both safe harbors, the nonelective employer contributions and the matching employer contributions would be treated in a manner similar to "qualified nonelective contributions," including being nonforfeitable immediately and generally not distributable prior to the participant's death, disability, termination of employment, or attainment of age 59 ½. In addition, each employee eligible to participate in the plan would have to be given notice of his or her rights and obligations under the plan within a reasonable period before the beginning of any year.

Simplification for plans that chose not to use the design-based safe harbors. The proposal would also simplify the nondiscrimination rules for plans that chose not to use the design-based safe harbors. First, the proposal would modify the ADP and ACP tests to provide that, unless an employer made an election to use current year data, the average contributions for highly compensated employees for the current year would be compared to the average contributions for nonhighly compensated employees for the *preceding* year. An election to use current year data could be revoked only as provided by the Secretary. For the first plan year of a 401(k) plan, the average percentage for nonhighly compensated employees would be deemed to be 3 percent or, at the employer's election or (except to the extent provided by the Secretary) in the case of a successor plan, the average percentage for that first plan year. Second, a simplified correction method would require excess contributions to be distributed first to those highly compensated employees who deferred the highest dollar amount (as opposed to the highest percentage of pay) for the year. Under this approach, the lower-paid highly compensated employees would no longer tend to bear the brunt of the correction method.

The design-based safe harbors would be effective for years beginning after December 31, 1998. The proposal relating to prior-year data and the correction procedures would be effective for years beginning after December 31, 1996.

REPEAL OF THE FAMILY AGGREGATION RULES
(Section 1104)

Current Law

If an employee is a family member of either a more-than-5 percent owner of the employer or one of the employer's ten highest-paid highly compensated employees, then any compensation paid to the family member and any contribution or benefit under the plan on behalf of the family member is aggregated with the compensation paid and contributions or benefits on behalf of the highly compensated employee. Therefore, the highly compensated employee and all family members are treated as a single highly compensated employee. For purposes of this rule, an employee's "family member" is generally a spouse, parent, grandparent, child, or grandchild (or the spouse of a parent, grandparent, child, or grandchild).

A similar family aggregation rule applies with respect to the $150,000 annual limit on the amount of compensation that may be taken into account under a qualified plan. (However, under these provisions, only the highly compensated employee's spouse and children and grandchildren under age 19 are aggregated.)

Reasons for Change

The family aggregation rules may unfairly reduce retirement benefits for family members who are not highly compensated employees and greatly complicate the application of the nondiscrimination tests, particularly for family-owned or operated businesses.

Proposal

The family aggregation rules would be repealed. The proposal would be effective for years beginning after December 31, 1996.

SIMPLIFY DEFINITION OF HIGHLY COMPENSATED EMPLOYEE
(Section 1105)

Current Law

A qualified retirement plan must satisfy various nondiscrimination tests to ensure that it does not discriminate in favor of "highly compensated employees." In order to apply these tests, the employer must identify its "highly compensated employees." This term is currently defined by reference to a test with seven major parts. Under this definition, an employee is treated as a highly compensated employee for the current year, if, at any time during the current year or the preceding year, the employee:

(1) owned more than 5 percent of the employer,

(2) received more than $100,000 (as indexed for 1996) in annual compensation from the employer,

(3) received more than $66,000 (as indexed for 1996) in annual compensation from the employer and was one of the top-paid 20 percent of employees during the same year, or

(4) was an officer of the employer who received compensation greater than $60,000 (as indexed for 1996).

These four rules are modified by three additional rules.

(5) An employee described in any of the last three categories for the current year but not the preceding year is treated as a highly compensated employee for the current year only if he or she was among the 100 highest paid employees for that year.

(6) No more than 50 employees or, if fewer, the greater of three employees or 10 percent of employees are treated as officers.

(7) If no officer has compensation in excess of $60,000 (for 1996) for a year, then the highest paid officer of the employer for the year is treated as a highly compensated employee.

Reasons for Change

The definition of highly compensated employee is not only complicated, it classifies many middle-income workers as "highly compensated employees" who are then prohibited from receiving higher levels of benefits.

Proposal

The current seven-part test would be replaced by a simplified two-part test: an employee would be a "highly compensated employee" for the current year only if the employee owned more than 5 percent of the employer during the current or preceding year *or* had compensation from the employer of more than $80,000 (indexed annually for changes in the cost of living after 1997) during the preceding year. This dollar threshold would mean that many middle-income Americans no longer would be subject to nondiscrimination restrictions.

The proposal would be effective for years beginning after December 31, 1996.

REPEAL OF LIMITATION IN CASE OF DEFINED BENEFIT PLAN AND DEFINED CONTRIBUTION PLAN FOR SAME EMPLOYEE

(Section 1106)

Current Law

An employee who participates in a qualified defined benefit plan and a qualified defined contribution plan of the same employer must also satisfy a combined plan limit. This limit is satisfied if the sum of the "defined benefit fraction" and the "defined contribution fraction" is no greater than 1.0.

The defined benefit fraction measures the portion of the maximum permitted defined benefit that the employee actually uses. The numerator is the projected normal retirement benefit, and the denominator is generally the lesser of 125 percent of the dollar limitation for the year, *or* 140 percent of the employee's percent of pay limitation.

The defined contribution fraction measures the portion that the employee actually uses of the maximum permitted contributions to a defined contribution plan for the employee's entire career with the employer. The numerator is generally the total of the contributions and forfeitures allocated to the employee's account for each of the employee's years of service with the employer. The denominator is the sum of a calculated value for each of those years of service. The calculated value is the lesser of 125 percent of the dollar limitation for that year of service, *or* 35 percent of the participant's compensation. Because of the historical nature of this fraction, its computation is extremely cumbersome and requires the retention of various data for an employee's entire career.

The combined plan limit is not the only Code provision that safeguards against an individual accruing excessive retirement benefits on a tax-favored basis. There are maximum limits for both defined benefit and defined contribution plans. In addition, a 15 percent "excess distribution" penalty was enacted in 1986 to achieve many of the same goals as the combined plan limit. A distribution is generally considered an "excess distribution" to the extent all distributions to an individual from all of the individual's qualified employer plans and IRAs exceed a specified dollar limit ($155,000 in 1996) during a calendar year. The limit is multiplied by five (i.e., $775,000 in 1996) for a lump sum distribution. Excess distributions made after death are subject to an additional estate tax of 15 percent. Other rules also protect against tax-favored excessive benefits.

Reasons for Change

Because other provisions of the Code, such as the excise tax on excess distributions, go far toward ensuring that an individual cannot accrue excessive retirement benefits on a tax-favored basis, the complexity of the combined plan limit is not justified.

Proposal

The combined plan limit (Code section 415(e)) would be repealed. This proposal would be effective for years beginning after December 31, 1998.

DISABLED EMPLOYEES
(Section 1107)

Current Law

An employer may elect to continue making deductible contributions to a defined contribution plan on behalf of permanently and totally disabled employees who are not highly compensated.

Reasons for Change

Contributions for disabled employees should be encouraged. In addition, contributions should be allowed for highly compensated disabled employees, as well as for nonhighly compensated disabled employees, if the contributions are provided on a nondiscriminatory basis.

Proposal

In order to simplify the rules for permanently and totally disabled workers and to encourage contributions for those disabled workers, an employer would not have to make an election in order to make contributions for disabled employees, and plans would generally be allowed to provide for contributions for disabled highly compensated employees, as well as for disabled nonhighly compensated employees.

This proposal would be effective for years beginning after December 31, 1996.

PLANS MAINTAINED BY SELF-EMPLOYED INDIVIDUALS
(Section 1108)

Current Law

Prior to the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), numerous special rules applied to qualified retirement plans that covered self-employed individuals. Almost all of these special rules were repealed by TEFRA. However, special aggregation rules that do not apply to other qualified retirement plans still apply to qualified plans that cover an "owner-employee" (i.e., a sole proprietor of an unincorporated trade or business or a more-than-10 percent partner of a partnership). These aggregation rules generally require affected plans to be treated as a single plan and affected employers to be treated as a single employer. For example, if an owner-employee controls more than one trade or business, then any qualified plans maintained with respect to those trades or businesses must be treated as a single plan and all employees of those trades or business must be treated as employed by a single employer.

Reasons for Change

The special aggregation rules afford plan participants little, if any, protection because they are largely duplicative of the general aggregation rules that apply to all qualified employer plans, including plans that cover self-employed individuals.

Proposal

The special aggregation rules for qualified plans that cover owner-employees would be repealed. As under current law, these plans would be subject to the general plan aggregation rules that apply to tax-qualified employer retirement plans.

This proposal would be effective for years beginning after December 31, 1996.

TRUST REQUIREMENT FOR DEFERRED COMPENSATION PLANS OF STATE AND LOCAL GOVERNMENTS
(Section 1109)

Current Law

Section 457 sets forth the tax rules applicable to nonqualified deferred compensation provided by a State or local government or tax-exempt organization. Under section 457, an employee who elects to defer the receipt of compensation under an "eligible plan" is taxed on the amounts deferred when the amounts are paid or made available. If a plan for the deferral of compensation is not an "eligible plan," the deferred compensation is taxed to the participant in the first taxable year in which the compensation is not subject to a substantial risk of forfeiture, even if the compensation is not paid or otherwise made available to the participant until a later date.

Amounts deferred under a section 457 plan, including all property purchased with such amounts and all income attributable to such amounts, must remain solely the property of the employer, subject to the claims of the employer's general creditors, until made available to the participant or beneficiary. Thus, compensation deferred by employees under a section 457 plan is not protected from the employer's general creditors in the event of the employer's bankruptcy. By contrast, the assets of a qualified cash or deferred arrangement must be held in trust for the exclusive benefit of participants and beneficiaries.

Reasons for Change

Employers should be encouraged to provide benefits under a qualified retirement plan, but a governmental employer may want to offer a section 457 plan. However, employees of a State or local government could lose the portion of their retirement savings that is in a 457 plan in the event that their employer became bankrupt.

Proposal

Under the proposal, all amounts deferred (including amounts deferred prior to the effective date of the change) under a section 457 plan maintained by a State or local government employer would be required to be held in trust (or in a custodial account or annuity contract) for the exclusive benefit of employees. Consequently, the requirement that amounts deferred under a section 457 plan be subject to the claims of the employer's creditors would be repealed with respect to section 457 plans of a governmental employer. The trust would be provided tax-exempt status. As under current law, amounts would not be includible in income until paid or made available to the employee, notwithstanding any tax provisions relating to economic benefit (e.g., without regard to section 83 or section 402(b)).

Other present-law requirements applicable to section 457 plans, including the annual limit on the maximum amount of deferral, would continue to apply. To the extent these requirements,

including the trust requirement, were not satisfied, amounts deferred would be includible in the employee's income when there is no substantial risk of forfeiture.

The proposal would not alter the present-law rules applicable to eligible section 457 plans of tax-exempt employers or the rules applicable to ineligible plans of governmental or tax-exempt employers.

The proposal would be effective for amounts under a section 457 plan on the date of enactment, but amounts would not be required to be held in trust until the end of the first calendar quarter beginning after the end of the first regular session (treating a two-year legislative session as two separate one-year sessions) of the State legislature of the State in which the governmental entity maintaining the plan is located that begins after the date of enactment.

CHAPTER 2 -- SIMPLIFICATION AND COST SAVINGS

TREATMENT OF GOVERNMENTAL AND MULTIEMPLOYER PLANS UNDER SECTION 415 AND TREATMENT OF EXCESS BENEFIT PLANS
(Section 1201)

Current Law

Annual benefits payable under a defined benefit plan are limited to the lesser of $120,000 (for 1996) or 100 percent of "three-year-high average compensation." (Reductions in the dollar or percentage limit for defined benefit plans may be required if the employee has fewer than 10 years of plan participation or service.) If benefits under a defined benefit plan begin before social security retirement age, the dollar limit must be actuarially reduced to compensate for the earlier commencement. Certain special rules apply to governmental plans.

The amount of reasonable compensation that may be provided to an employee under a nonqualified deferred compensation arrangement maintained by a for-profit organization generally is not subject to any limitation. Many such employers maintain a nonqualified "excess benefit plan" that provides benefits for certain employees in excess of the limitations on annual contributions and benefits imposed by section 415 of the Code. The nonqualified deferred compensation is not taxable to the employee until it is paid or otherwise made available to the employee to draw upon at any time.

Section 457 sets forth the tax rules applicable to nonqualified deferred compensation provided by a State or local governments or tax-exempt organization. Under section 457, an employee who elects to defer the receipt of compensation under an "eligible plan" is taxed on the amounts deferred when the amounts are paid or made available. A section 457 plan is not an eligible plan unless, among other requirements, annual deferrals for an employee are limited to the lesser of $7,500 or 33 1/3 percent of compensation. If a plan for the deferral of compensation is not an "eligible plan," the deferred compensation is taxed to the participant in the first taxable year in which the compensation is not subject to a substantial risk of forfeiture, even if the compensation is not paid or otherwise made available to the participant until a later date.

Reasons for Change

The qualified plan limitations are uniquely burdensome for governmental plans, which have long-established benefits structures and practices that may conflict with the limitations. In addition, some State constitutions may significantly restrict the ability to make the changes needed to conform the plans to these limitations.

These limitations also present problems for many multiemployer plans. These plans typically base benefits on years of credited service, not on a participant's compensation. In addition, the 100 percent-of-compensation limit is based on an employee's average compensation for the three highest *consecutive* years. This rule often produces an artificially low limit for employees in certain industries, such as building and construction, where wages vary significantly from year to year.

An excess benefit plan provides to certain employees -- those whose contributions or benefits are reduced by the section 415 limits -- contributions or benefits that are already provided to other employees under a qualified plan. Even though an excess benefit plan does not provide management employees with disproportionately higher benefits than those provided to lower paid employees, the restrictions of section 457 still apply to such a plan if it is maintained by a State or local government or tax-exempt organization. These employers are therefore at a disadvantage in attempting to provide all employees with proportionate contributions or benefits.

Proposal

The rules for governmental plans and multiemployer plans would be modified to eliminate the 100 percent-of-compensation limit (but not the $120,000 limit) for such plans, and to exempt certain survivor and disability benefits from the adjustments for early commencement and for participation and service of less than 10 years. To the extent that governmental employers have previously made elections that would prevent them from utilizing these simplification provisions, the proposal would allow those employers to revoke their elections.

The proposal would exempt excess benefit plans of State and local governments and tax-exempt organizations from section 457. The exemption would not apply to an excess benefit plan that also provided benefits in excess of qualified plan limitations other than the section 415 limits.

These proposals generally would be effective for years beginning after December 31, 1996. The provisions relating to governments would be effective for years beginning after December 31, 1995.

DEFINITION OF COMPENSATION FOR SECTION 415 PURPOSES
(Section 1202)

Current Law

Annual additions to a defined contribution plan for any participant are limited to the lesser of $30,000 (for 1996) or 25 percent of compensation. Annual benefits payable under a defined benefit plan are limited to the lesser of $120,000 (for 1996) or 100 percent of "three-year-high average compensation." For purposes of the various compensation limits, compensation generally does not include employer contributions (including elective deferrals) made to section 401(k) plans, section 403(b) annuities, section 125 cafeteria plans, and certain other employee benefit plans.

Reasons for Change

The exclusion of elective deferrals restricts the amount that employees can accrue under a qualified plan. Because the dollar limit is usually the operative limit for a highly compensated employee, and the percent-of-compensation limit is usually the operative limit for nonhighly compensated employees, the exclusion of elective contributions from the definition of compensation is not only complicated, but it primarily limits benefits for nonhighly compensated employees.

Proposal

Under the proposal, elective contributions would be considered compensation for purposes of the annual limits on contributions and benefits. This proposal would be effective for years beginning after December 31, 1996.

ASSUMPTIONS FOR ADJUSTING CERTAIN BENEFITS OF DEFINED BENEFIT PLANS FOR EARLY RETIREES

(Section 1203)

Current Law

Annual benefits payable under a defined benefit plan are limited to the lesser of $120,000 (for 1996) or 100 percent of "three-year-high average compensation." (Reductions in the dollar or percentage limit for defined benefit plans may be required if the employee has fewer than 10 years of plan participation or service.) If benefits begin before social security retirement age, the dollar limit must be actuarially reduced to compensate for the earlier commencement. Certain special rules apply to governmental plans. In addition, if benefits are paid in a form other than a straight life annuity (or a joint and survivor annuity), the benefits must be adjusted to an actuarially equivalent straight life annuity prior to comparison with the dollar limitation.

The reduction to the dollar limit for commencement between age 62 and social security retirement age is based on the early commencement factors used for social security. The interest rate that must be used for the actuarial reductions for any commencement prior to age 62, and for purposes of the benefit adjustment, depends on the form of the benefit that is being paid. If the benefit is being paid in an annuity distribution, the interest rate that must be used for both of these adjustments is the greater of 5 percent or the interest rate used for the parallel adjustments under the plan. However, if the benefit is being paid in a nonannuity form (e.g., a single sum distribution), the interest rate that must be used for both of these adjustments is the greater of the interest rate applicable under section 417(e)(3) or the interest rate used for the parallel adjustments under the plan.

Reasons for Change

The requirement that the interest rate used for the early commencement actuarial adjustment vary depending on whether or not the benefit is payable in an annuity form adds complexity to the calculation of the maximum benefit limitations that is not justified.

Proposal

The actuarial assumptions to be used for adjusting the $120,000 limit for commencement prior to age 62 would be based on the greater of 5 percent or the interest rate used for this purpose under the plan, without regard to the form of benefit that is being paid. This proposal would be effective as if it were included in the Retirement Protection Act of 1994.

TREATMENT OF DEFERRED COMPENSATION PLANS OF STATE AND LOCAL GOVERNMENT AND TAX-EXEMPT ORGANIZATIONS
(Section 1204)

Current Law

The amount of reasonable compensation that may be provided to an employee under a nonqualified deferred compensation arrangement maintained by a for-profit organization generally is not subject to any limitation. Many such employers maintain a nonqualified "excess benefit plan" that provides benefits for certain employees in excess of the limitations on annual contributions and benefits imposed by section 415 of the Code. The nonqualified deferred compensation is not taxable to the employee until it is paid or otherwise made available to the employee to draw upon at any time.

Section 457 sets forth the tax rules applicable to nonqualified deferred compensation provided by a State or local governments or tax-exempt organization. Under section 457, an employee who elects to defer the receipt of compensation under an "eligible plan" is taxed on the amounts deferred when the amounts are paid or made available. If a plan for the deferral of compensation is not an "eligible plan," the deferred compensation is taxed to the participant in the first taxable year in which the compensation is not subject to a substantial risk of forfeiture, even if the compensation is not paid or otherwise made available to the participant until a later date.

A section 457 plan is not an eligible plan unless, among other requirements, annual deferrals for an employee are limited to the lesser of $7,500 or 33 1/3 percent of compensation. In contrast to other dollar limitations applicable to employee benefit plans, the $7,500 limit is not indexed for cost of living. In addition, amounts deferred under an eligible plan may not be made available to a participant before the earlier of the calendar year in which the participant attains age 70 ½, the participant's separation from service, or an unforeseeable emergency. Benefits under an eligible plan are not considered made available if the participant may elect to receive a lump sum payable after separation from service and within 60 days of the election. However, this exception is available only if the total amount payable to the participant under the plan does not exceed $3,500 and no additional amounts may be deferred under the plan with respect to the participant.

Reasons for Change

In order to maintain the value of deferrals under an eligible section 457 plan, the dollar limits on deferrals should be indexed in a manner that is consistent with the way other plan dollar limits are indexed. In addition, the existing constructive receipt rules that apply to section 457 plans are unnecessarily restrictive.

Proposal

The proposal would provide for increases in the $7,500 limit, based on changes in the cost of living since 1994. The indexed value would be rounded down to the next lower multiple of $500.

The proposal would also permit the in-service distribution of a participant's account if that account did not exceed $3,500, no amount was deferred under the plan with respect to the participant for two years, and there was no prior distribution under this cash-out rule. In addition, the proposal would allow an additional election to be made with respect to the time distributions must begin under the plan. The amount payable to a participant under an eligible plan would not be treated as made available merely because the participant could elect to defer commencement of distributions under the plan after amounts could be distributed under the plan but before the actual commencement of benefits. Only one such additional election would be permitted.

These proposals would be effective for taxable years beginning after December 31, 1996.

NO REQUIRED DISTRIBUTIONS FOR ACTIVE EMPLOYEES
(Section 1205)

Current Law

Under current law, an employee who participates in a qualified employer retirement plan must begin taking distributions of his or her benefit by the April 1 following the year in which he or she reaches age 70 ½. Generally, the so-called "minimum distribution" for any year is determined by dividing the employee's account balance or accrued benefit by the employee's life expectancy.

Reasons for Change

If the employee is still working and accruing new benefits at age 70 ½, the new benefits must be taken into account to determine the minimum amount required to be distributed for the same year. In effect, a portion of each year's new benefit accrual is required to be distributed in the same year. This pattern of contemporaneous contributions and required distributions causes considerable complication and confusion.

Proposal

The requirement to distribute benefits before retirement would be eliminated, except for employees who own more than 5 percent of the employer that sponsors the plan. Instead, distributions would have to begin by the April 1 following the *later of* the year in which the employee reaches age 70 ½ or the year in which the employee retires from service with the employer maintaining the plan. If payment of an employee's benefits were delayed past age 70 ½ pursuant to this rule, the benefits ultimately paid at retirement would have to be actuarially increased to take into account the delay in payment. Without this increase, the delay in payment could cause the employee to "lose" the benefit payments that would otherwise have been paid between age 70 ½ and retirement. The actuarial adjustment rule and the 5 percent owner rule would not apply to a governmental plan or a church plan.

The age-70 ½ requirement would continue to apply to IRAs. Because an IRA is not maintained by an employer, the initial payment date for an IRA cannot be tied to retirement from the employer maintaining the plan. (Note that this Act also includes a separate item that would change the age-70 ½ rule to an age-70 rule.)

The proposal would be effective for years beginning after December 31, 1996.

SIMPLIFY TAXATION OF ANNUITY DISTRIBUTIONS
(Section 1206)

Current Law

If an employee makes after-tax contributions to a qualified employer retirement plan or IRA, those contributions (i.e., the employee's "basis") are not taxed upon distribution. When the plan distributions are in the form of an annuity, a portion of each payment is considered nontaxable return of basis. This nontaxable portion is determined by multiplying the distribution by an exclusion ratio. The exclusion ratio generally is the employee's total after-tax contributions divided by the total expected payments under the plan over the term of the annuity.

Reasons for Change

The determination of the total expected payments, which is based on the type of annuity being paid, often involves complicated calculations that are difficult for the average plan participant. Because of the difficulty an individual may face in calculating the exclusion ratio, and in applying other special tax rules that may be applicable, the IRS in 1988 provided a simplified alternative method for determining the nontaxable portion of an annuity payment. However, this alternative has effectively added to the existing complexity because taxpayers feel compelled to calculate the nontaxable portion of their payments under every possible method in order to ensure that they maximize the nontaxable portion.

Proposal

A simplified method for determining the nontaxable portion of an annuity payment, similar to the current simplified alternative, would become the required method. Taxpayers would no longer be compelled to do calculations under multiple methods in order to determine the most advantageous approach.

Under the simplified method, the portion of an annuity payment that would be nontaxable is generally equal to the employee's total after-tax employee contributions, divided by the number of anticipated payments listed in a table (based on the employee's age as of the annuity starting date).

The proposal would be effective with respect to annuity starting dates on or after January 1, 1997.

REPEAL FIVE-YEAR AVERAGING FOR LUMP SUM DISTRIBUTIONS
(Section 1207)

Current Law

A distribution that satisfies the many requirements necessary to qualify as a "lump sum distribution" is eligible for five-year forward averaging. Under this method, the tax that is owed on the lump sum distribution is separately calculated and added to the individual's other income tax for the year. The separate tax is approximately equal to five times the tax that would apply to one-fifth of the distribution, assuming the taxpayer had no other taxable income. Because the tax on the distribution is calculated separately from other income and because the distribution is taxed at the marginal rate that would apply to one-fifth of the distribution, a recipient who receives a large distribution in one taxable year may be able to benefit from a lower marginal tax rate by using five-year forward averaging.

Prior to the Tax Reform Act of 1986 (TRA 1986), lump sum distributions were eligible for 10-year averaging rather than five-year averaging. In addition, the portion of a lump sum distribution attributable to pre-1974 services could be treated as capital gain. These rules may be used currently only if the employee attained age 50 before January 1, 1986.

Reasons for Change

Both the definition of a lump sum distribution and the calculation of tax under the five-year averaging method are complicated. In addition, the problem that five-year averaging addresses (i.e., avoiding the bunching of income in one year, resulting in an unusually high tax rate for that year) can be achieved by rolling over a lump sum distribution to an IRA without tax and taking periodic payments from the IRA over five years or more. In 1992, the availability of tax-free rollovers was expanded and the rules for rollovers were simplified significantly.

Proposal

The five-year averaging rules would be repealed, effective for lump sum distributions after December 31, 1998. However, the grandfather provisions of TRA 1986 that permit ten-year averaging and capital gain treatment to be used by employees who attained age 50 before January 1, 1986 would be retained.

ELIMINATION OF HALF-YEAR REQUIREMENTS
(Section 1208)

Current Law

In general, distributions from qualified employer plans and IRAs prior to age 59 ½ are subject to a 10 percent penalty. In addition, under certain plans (such as section 401(k) plans), distributions before age 59 ½ are generally prohibited. Minimum distributions from IRAs and qualified employer plans are required to begin after attainment of age 70 ½. (Note that this Act also includes a separate item that would eliminate the requirement that distributions from qualified employer plans begin by age 70 ½ for employees, other than more-than-5 percent owners, who have not yet retired.)

Reasons for Change

Requirements based on half years are not as simple to apply or communicate as requirements based on whole years, and may lead to confusion as to when distributions to IRA and qualified plan participants must commence and when distributions may be subject to penalty. The exact date on which an individual reaches age 59 ½ or age 70 ½ may not be readily apparent, whereas an individual's date of birth is obviously known to the individual and is typically included in plan and employer records.

Proposal

To simplify these provisions, all references to age 59 ½ would be changed to age 59, and all references to age 70 ½ would be changed to age 70.

The proposal would be effective for years beginning after December 31, 1996.

DISTRIBUTIONS UNDER RURAL COOPERATIVE PLANS
(Section 1209)

Current Law

Under a section 401(k) plan, distributions are generally only allowed after separation from service, death, disability, attainment of age 59 ½, or hardship. However, 401(k) plans that qualify as "rural cooperative plans" (e.g., 401(k) plans maintained by rural electrical cooperatives or cooperative telephone companies) are money purchase pension plans. Therefore, in accordance with the distribution restrictions generally applicable to pension plans, these plans cannot allow distributions prior to the earlier of a participant's separation from service or normal retirement.

Reasons for Change

It is appropriate to allow a 401(k) plan maintained by a rural cooperative to permit distributions to plan participants under the same circumstances as a 401(k) plan maintained by other employers.

Proposal

The rules governing distributions from a 401(k) plan of a rural cooperative would be conformed to those that apply to other 401(k) plans by allowing distributions after attainment of age 59 ½ and upon financial hardships. This proposal would be effective for distributions after date of enactment.

MODIFICATION OF ADDITIONAL PARTICIPATION REQUIREMENTS
(Section 1210)

Current Law

Under current law, every qualified defined benefit plan or defined contribution plan is required to cover at least 50 employees or, in smaller companies, 40 percent of all employees of the employer. This rule was intended primarily to prevent an employer from establishing individual defined benefit plans for highly compensated employees in order to provide those employees with more favorable benefits than those provided to lower paid employees under a separate plan. The rule prevents an employer from favoring one small group of participants over another by, for example, covering them under two separate plans and funding one plan better than the other.

Reasons for Change

As applied to defined contribution plans, the minimum participation rule adds complexity for employers without delivering commensurate benefits to the system, given that the nondiscrimination rules also prevent qualified retirement plans from unduly favoring the top-paid group of employees. The abuses intended to be addressed by the minimum participation requirement rarely arise in the context of defined contribution plans. Accordingly, this requirement adds unnecessary administrative burden and complexity with respect to these plans.

Proposal

The minimum participation rule would be repealed for defined contribution plans. In addition, if an employer had only two employees, the rule for defined benefit plans would be modified to require any such plan to cover both employees.

The proposal would be effective for plan years beginning after December 31, 1996.

UNIFORM RETIREMENT AGE
(Section 1211)

Current Law

Several of the statutory requirements for qualified employer plans involve "normal retirement age." Under most of these provisions, normal retirement age can be no later than age 65. However, under certain other provisions, normal retirement is the social security retirement age (currently age 65, but scheduled to increase).

Reasons for Change

Many retirement plans base benefits on social security age in order for the benefits to complement social security. Yet, under current law, the use of social security retirement age (which is not uniform among participants) may cause the plan to fail applicable nondiscrimination tests, since those tests generally require the use of a retirement age that is uniform among participants.

Proposal

Under the proposal, the social security retirement age would be a uniform retirement age for purposes of the nondiscrimination rules. In addition, subsidized early retirement benefits and joint and survivor annuities would not be treated as not being available to employees on the same terms merely because they were based on an employee's social security retirement age.

This proposal would be effective for years beginning after December 31, 1996.

TREATMENT OF LEASED EMPLOYEES
(Section 1212)

Current Law

Individuals who are "leased employees" of a service recipient are considered to be employees of that recipient for qualified retirement plan and certain other purposes. A "leased employee" is any person who is not a common-law employee of the recipient and who provides services to the recipient if (1) the services are provided pursuant to an agreement between the recipient and the employer of the service provider, (2) the person has performed the services for the recipient on a substantially full-time basis for at least one year, and (3) the services are of a type historically performed, in the business field of the recipient, by employees.

Reasons for Change

The historically performed standard produces many unintended and inappropriate results. For example, under this standard, employees and partners of a law firm could be leased employees of a client of the firm if they work a sufficient number of hours for the client, assuming that it is not unusual for employers in the client's business to have in-house counsel.

Proposal

The "historically performed" test would be replaced by a test that considers whether the services performed for the recipient are performed under significant direction or control by the recipient.

This proposal would generally be effective for years beginning after December 31, 1996, but would not apply to relationships that have been previously determined by an IRS ruling not to involve leased employees.

FULL FUNDING LIMITATION FOR MULTIEMPLOYER PLANS
(Section 1213)

Current Law

An employer's annual deduction for contributions to a defined benefit plan is generally limited to the amount by which 150 percent of the plan's current liability (or, if less, 100 percent of the plan's accrued liability) exceeds the value of the plan's assets. The 150 percent-of-current-liability limit restricts the extent to which an employer can deduct contributions for benefits that have not yet accrued.

Defined benefit plans are required to have an actuarial valuation no less frequently than annually.

Reasons for Change

An employer has little, if any, incentive to make "excess" contributions to a multiemployer plan. The amount an employer contributes to a multiemployer plan is fixed by the collective bargaining agreement, and a particular employer's contributions are not set aside to pay benefits solely to the employees of that employer.

Proposal

The 150 percent limit on deductible contributions would be eliminated for multiemployer plans. Therefore, the annual deduction for contributions to such a plan would be limited to the amount by which the plan's accrued liability exceeds the value of the plan's assets. In addition, actuarial valuations would be required under the Code no less frequently than every three years for multiemployer plans. Parallel changes would be made to ERISA.

The proposal would be effective for years beginning after December 31, 1996.

ELIMINATION OF PARTIAL TERMINATION RULES FOR MULTIEMPLOYER PLANS
(Section 1214)

Current Law

When a qualified retirement plan is terminated, all plan participants are required to become 100 percent vested in their accrued benefits to the extent those benefits are funded. In the case of certain "partial terminations" that are not actual plan terminations (e.g., a large reduction in the work force), all affected employees must become 100 percent vested in their benefits accrued to the date of the termination, to the extent the benefits are funded.

Whether a partial termination has occurred in a particular situation is generally based on the specific facts and circumstances of that situation, including the exclusion from the plan of a group of employees who have previously been covered by the plan, by reason of a plan amendment or severance by the employer. In addition, if a defined benefit plan stops or reduces future benefit accruals under the plan, a partial termination is deemed to occur if, as a result, a potential reversion of plan assets to the employer is created or increased

Reasons for Change

Over the years, court decisions have left unanswered many key questions as to how to apply the partial termination rules. Accordingly, applying the rules can often be difficult and uncertain, especially for multiemployer plans. For example, multiemployer plans experience frequent fluctuations in participation levels caused by the commencement and completion of projects that involve significant numbers of union members. Many of these terminated participants are soon rehired for another project that resumes their active coverage under the plan. In addition, it is common for participants leaving one multiemployer plan's coverage to maintain service credit under a reciprocal agreement if they move to the coverage of another plan sponsored by the same union. As a result, these participants do not suffer the interruption of their progress along the plan's vesting schedule that ordinarily occurs when an employee stops being covered by a plan. Given these factors, and the related proposal to require multiemployer plans to vest participants after five (instead of the current ten) years of service, the difficulties associated with applying the partial termination rules to multiemployer plans outweigh the benefits.

Proposal

The requirement that affected participants become 100 percent vested in their accrued benefits (to the extent funded) upon the partial termination of a qualified employer retirement plan would be repealed with respect to multiemployer plans.

The proposal would be effective for partial terminations that begin on or after January 1, 1997.

ELECTIVE DEFERRALS UNDER SECTION 403(b)
(Section 1215)

Current Law

Annual elective deferrals made by an employee under a section 403(b) annuity plan generally are limited to $9,500. Elective deferrals in excess of this limit may be corrected by distributing the excess deferrals no later than April 15 of the year following the year of deferral. If the excess is not timely corrected, the excess deferrals are includible in the employee's income in the year of deferral and again in the year of distribution. In addition, a 403(b) annuity plan must provide that elective deferrals made under the plan may not exceed the annual limit. Plans that do not comply with this requirement may lose their tax-qualified status.

Reasons for Change

Employees participating in a 403(b) annuity plan should not be adversely affected if other employees violate the annual limit on elective contributions with respect to their individual contracts or custodial accounts.

Proposal

Under the proposal, each 403(b) annuity contract, not the 403(b) plan, must provide that elective deferrals made under the contract may not exceed the annual limit.

This proposal would be effective for years beginning after December 31, 1996.

UNIFORM PENALTY PROVISIONS TO APPLY TO CERTAIN PENSION REPORTING REQUIREMENTS
(Section 1216)

Current Law

The penalty structure for failure to provide information reports with respect to pension payments is currently separate and different from the penalty structure that applies to information reporting in other areas. The penalty for failure to file a Form 1099-R report of pension distributions is currently $25 per day per return, up to a maximum of $15,000 per year per return. The penalty for failure to file a Form 5498 IRA report is currently a flat $50 per return, with no maximum, regardless of the number of returns.

In contrast, the penalty for failure to file any other information return is generally $50 per return up to $250,000 per year, with lower penalties and maximums if the return is filed within specified times. (The penalty is $15 per return filed late but within 30 days and $30 per return filed late but on or before August 1.) Lower maximums also apply to persons with gross receipts of no more than $5 million. The penalty for failure to furnish a payee statement is $50 per payee statement up to $100,000 per year. (Under a separate proposal, the general penalty amount would be increased to the greater of $50 per return or five percent of the total amount required to be reported, unless the aggregate amount reported by the trustee for the calendar year is at least 97 percent of the amount required to be reported.) Separate penalties apply in the case of intentional disregard of the requirement to furnish a payee statement.

Reasons for Change

Conforming the information reporting penalties that apply with respect to pension payments to the general information reporting penalty structure would simplify the overall penalty structure by providing uniformity and would provide more appropriate penalties with respect to pension payments.

Proposal

The penalties for failure to provide information reports with respect to pension payments would be conformed to the general penalty structure. Thus, the penalty for failure to file Form 1099-R would generally be reduced (for any return that was late by more than two days). The penalty for failure to file Form 5498 would generally remain the same as under current law, but would no longer be unlimited. In addition, for both Form 1099-R and Form 5498, the penalties would be reduced if the forms were filed late but within specified times.

The proposal would apply to returns and statements for which the due date (determined without regard to extensions) is after December 31, 1996.

TAX ON PROHIBITED TRANSACTIONS
(Section 1217)

Current Law

A "prohibited transaction" under section 4975 is generally any transaction between a plan and a person who is considered a "disqualified person" with respect to the plan. Unless exempt by statute or by an individual or class exemption, a prohibited transaction gives rise to an excise tax (imposed on the disqualified person) equal to 5 percent of the amount involved in the transaction. If the transaction is not corrected, an additional 100 percent excise tax may be imposed. ERISA includes a parallel civil penalty for any prohibited transactions involving a plan that is not subject to section 4975 of the Code.

Reasons for Change

A 10 percent excise tax should be more effective in discouraging prohibited transactions than the current 5 percent excise tax.

Proposal

The proposal would increase the initial excise tax on transactions from 5 percent to 10 percent, effective for transactions occurring after December 31, 1996. A parallel change would be made to the ERISA civil penalty.

DATE FOR ADOPTION OF PLAN AMENDMENTS
(Section 1218)

Current Law

Plan amendments that are made to reflect amendments to the Internal Revenue Code must generally be made by the employer's income tax return due date for the employer's taxable year in which the change in the law occurs.

Reasons for Change

Plan sponsors should be given adequate time to amend plan documents following the enactment of legislation that requires plans to be amended.

Proposal

In order to ensure that plan sponsors have adequate time to amend plan documents, plan amendments required by this Title would not be required to be made before the end of the first plan year beginning on or after January 1, 1998, if the plan were operated in accordance with the applicable provision and the amendment were retroactive to the effective date of the applicable provision. Governmental employers would have a later date.

SUBTITLE B --EXPANDED INDIVIDUAL RETIREMENT ACCOUNTS TO INCREASE COVERAGE AND PORTABILITY

(Sections 1301 - 1331)

Current Law

Under current law, an individual may make deductible contributions to an individual retirement account or individual retirement annuity (IRA) up to the lesser of $2,000 or compensation (wages and self-employment income). (The dollar limit is $2,250 if the individual's spouse has no compensation.) If the individual (or the individual's spouse) is an active participant in an employer-sponsored retirement plan, the $2,000 limit on deductible contributions is phased out for couples filing a joint return with adjusted gross income (AGI) between $40,000 and $50,000, and for single taxpayers with AGI between $25,000 and $35,000. To the extent that an individual is not eligible for deductible IRA contributions, he or she may make nondeductible IRA contributions (up to the contribution limit).

The earnings on IRA account balances are not includable in gross income until they are withdrawn. Withdrawals from an IRA (other than withdrawals of nondeductible contributions) are includable in income, and must begin by age 70½. Amounts withdrawn before age 59½ are generally subject to an additional 10-percent tax. This 10-percent early withdrawal tax does not apply to distributions upon the death or disability of the taxpayer or to substantially equal periodic payments over the life (or life expectancy) of the IRA owner or over the joint lives (or life expectancies) of the IRA owner and his or her beneficiary. In general, an excess distribution tax of 15 percent applies to the extent that an individual receives an aggregate amount of retirement distributions in excess of $155,000 in any year.

Reasons for Change

The Administration believes that individuals should be encouraged to save, both in order to provide for long-term needs, such as retirement and education, and in order to sustain a sufficient level of private investment to continue the healthy growth of the economy. Targeted tax policies can provide an important incentive for savings. Under current law, however, savings incentives in the form of deductible IRAs are not available to all middle-income taxpayers. Furthermore, the present-law income thresholds for deductible IRAs and the maximum contribution amount are not indexed for inflation, so that fewer Americans are eligible to make a deductible IRA contribution each year, and the amount of the maximum contribution is declining in real terms over time. The Administration also believes that providing taxpayers with the option of making IRA contributions that are nondeductible but can be withdrawn tax free will provide an alternative savings vehicle that some middle-income taxpayers may find more suitable for their savings needs.

Individuals save for many purposes besides retirement. Broadening the tax incentives for non-retirement saving can help increase the nation's savings rate. IRAs that are flexible enough to meet a variety of essential savings needs, such as first-time home purchases, higher education expenditures, unemployment, and catastrophic medical and nursing home expenses, should prove to be more attractive to many taxpayers than accounts that are limited to retirement savings.

Proposal

Expand Deductible IRAs

Under the proposal, the income thresholds and phase-out ranges for deductible IRAs would be doubled, in two stages. Beginning in 1996, eligibility would be phased out for couples filing joint returns with AGI between $70,000 and $90,000 and for single individuals with AGI between $45,000 and $65,000. Beginning in 1999, eligibility would be phased out for couples filing joint returns with AGI between $80,000 and $100,000 and for single individuals with AGI between $50,000 and $70,000. The income thresholds and the present-law annual contribution limit of $2,000 would be indexed for inflation. As under current law, any individual who is not an active participant in an employer-sponsored plan and whose spouse is also not an active participant would be eligible for deductible IRAs regardless of income.

Under the proposal, the IRA contribution limit would be coordinated with the current-law limits on elective deferrals under qualified cash or deferred arrangements (section 401(k) plans), tax-sheltered annuities (section 403(b) annuities), and similar plans. The proposal also would provide that the current-law exclusion from the 10-percent early withdrawal tax for IRA withdrawals after an individual reaches age 59½ does not apply in the case of amounts attributable to contributions (excluding rollovers from tax-qualified plans or tax-sheltered annuities) made during the previous five years.

Special IRAs

Each individual eligible for a traditional deductible IRA would have the option of contributing an amount up to the contribution limit either to a deductible IRA or to a new "Special IRA." Contributions to this Special IRA would not be tax deductible, but distributions of the contributions would be tax-free. If the contributions remained in the account for at least five years, distributions of the earnings on the contributions also would be tax-free. Withdrawals of earnings from Special IRAs during the five-year period after contribution would be subject to ordinary income tax. In addition, such withdrawals would be subject to the 10-percent early withdrawal tax unless used for one of the four purposes described below.

The proposal would permit individuals whose AGI for a taxable year does not exceed the upper end of the new income eligibility limits ($100,000 for couples filing joint returns and $70,000 for single individuals) to convert balances in deductible IRAs into Special IRAs without being subject to the early withdrawal tax. The amount converted from the deductible IRA to the Special IRA generally would be includable in the individual's income in the year of the conversion. However, if a conversion was made before January 1, 1998, the converted amount included in the individual's income (and taken into account in applying the 15-percent excess distribution tax) would be spread evenly over four taxable years.

Distributions Not Subject to Early Withdrawal Tax

Amounts withdrawn from deductible IRAs and Special IRAs within the five-year period after contribution would not be subject to the early withdrawal tax, if the taxpayer used the amounts to pay

post-secondary education costs, to buy or build a first home, to cover living costs if unemployed, or to pay catastrophic medical expenses (including certain nursing home costs).

Education expenses. The early withdrawal tax would not apply to the extent the amount withdrawn is used to pay qualified higher education expenses of the taxpayer, the taxpayer's spouse, the taxpayer's dependent, or the taxpayer's child or grandchild (even if not a dependent). In general, a withdrawal for qualified higher education expenses would be subject to the same requirements as the deduction for qualified educational expenses (e.g., the expenses are tuition and fees that are charged by educational institutions and are directly related to an eligible student's course of study).

In addition, to further assist taxpayers who are saving to pay these qualified higher education expenses, deductible IRAs and Special IRAs would be expressly permitted to invest in qualified State prepaid tuition program instruments to the extent provided by the Secretary. In general, a qualified State prepaid tuition program instrument is one issued under a program established or maintained by a State, that can be converted into a percentage of tuition expenses for an individual if the funds are used to pay tuition expenses, or can be redeemed for an amount not less than the purchase price (less any reasonable administrative fees), if the funds are not used for education. To the extent a qualified instrument held by an IRA is converted into tuition and fees, the IRA owner will be treated as having received a distribution from the IRA to pay qualified higher education expenses. No inference is intended as to the tax treatment of prepaid tuition programs under current law or for other purposes of the Code.

First-time home purchasers. The early withdrawal tax would not apply to the extent the amount withdrawn is used to pay qualified acquisition, construction, or reconstruction costs with respect to a principal residence of a first-time home buyer who is the taxpayer, the taxpayer's spouse, or the taxpayer's child or grandchild.

Unemployment. Withdrawals would not be subject to the early withdrawal tax if (1) the individual has separated from employment, (2) the individual has received unemployment compensation for 12 consecutive weeks, and (3) the withdrawal is made during the taxable year in which the unemployment compensation is received or the succeeding taxable year.

Medical care expenses and nursing home costs. The proposal would extend to IRAs the present-law exception to the early withdrawal tax for distributions from qualified plans and tax-sheltered annuities for certain medical care expenses (deductible medical expenses that are subject to a floor of 7.5 percent of AGI) and would expand the exception for IRAs to allow withdrawal for medical care expenses (in excess of 7.5 percent of AGI) of the taxpayer's child, grandchild, parent or grandparent, whether or not that person otherwise qualifies as the taxpayer's dependent.

In addition, for purposes of the exclusion from the early withdrawal tax for distributions from IRAs, the definition of medical care would include expenses for qualified long-term care services for incapacitated individuals.

All of the proposed IRA provisions would be effective January 1, 1996. Conditions under which the IRA provisions would continue or terminate after December 31, 2000 are generally described in the Budget of the United States Government, Fiscal Year 1997, page 1.

SUBTITLE C -- OTHER EXPANSIONS OF PENSION PORTABILITY

ALTERNATIVE NONDISCRIMINATION RULES FOR CERTAIN PLANS THAT PROVIDE FOR EARLY PARTICIPATION
(Section 1401)

Current Law

The actual deferral percentage (ADP) test applicable to section 401(k) plans compares the average rate of elective contributions for nonhighly employees who "benefit" under the plan with the average rate of elective contributions for highly compensated employees who benefit under the plan. For this purpose, an employee is considered to benefit under the plan if the employee is eligible for elective contributions. A similar actual contribution percentage (ACP) test applies to employer matching contributions and employee after-tax contributions under section 401(m).

In general, a plan need not permit employees to enter a plan prior to the attainment of age 21 and the completion of 1 year of service. For purposes of testing nondiscrimination (including the ACP and ADP tests), an employer that chooses less restrictive entry conditions (e.g., age 18 rather than age 21) may choose "separate testing" under which all employees who have not met the statutory age and service entry maximums are disregarded, provided that the plan satisfies the nondiscrimination rules taking into account only those employees whose age and service are less than the statutory age and service maximums. Thus, such a plan would apply one ADP test for employees who are over age 21 with 1 year of service, under which the plan would disregard the rates of elective contributions for other employees, and a second ADP test looking solely at the rates of elective contribution for employees under age 21 or who have not completed 1 year of service.

Reasons for change

Many employers do not permit employees to make salary reduction contributions or receive matching contributions until the employees meet certain specified age and service requirements (commonly age 21 and 1 year of service). Some employers are concerned that allowing these newly hired employees to participate in the plan might cause the plan to fail the ADP or ACP tests, even when the plan chooses the separate testing option of current law. However, if newly hired employees are required to wait before payroll deductions can begin, they might not get into or continue the habit of saving for retirement through payroll deduction.

Proposal

The proposal provides an alternative method of applying the ADP test for a section 401(k) plan that allows employees to participate before they have completed one year of service and reached age 21, if the plan satisfies the minimum coverage rules of section 410(b) using the option of section 410(b)(4)(B). Instead of applying two separate ADP tests, such a plan could apply a single ADP test that compares the average rate of elective contributions for all highly compensated employees who are eligible to make elective contributions with the average rate of elective contributions for those nonhighly compensated employees who are eligible to make elective contributions and who have completed one year of service and reached age 21. Similar rules would apply for purposes of the ACP test. The provisions would be effective for plan years beginning after December 31, 1996.

TREATMENT OF CERTAIN VETERANS' REEMPLOYMENT RIGHTS
(Section 1402)

Current Law

Under the Uniformed Services Employment and Reemployment Rights Act of 1994 ("USERRA"), which revised and restated the Federal law protecting veterans' reemployment rights, a returning veteran generally is entitled to the restoration of certain pension, profit sharing and similar benefits that would have accrued but for the employee's absence due to the military service. USERRA generally provides that service in the uniformed services is considered service with the employer for retirement plan benefit accrual purposes. USERRA also provides that the reemployed veteran is entitled to any accrued benefits that are contingent on the making of, or derived from, employee contributions or elective deferrals, but only to the extent the reemployed veteran makes payment to the plan with respect to such contributions or deferrals. No such payment may exceed the amount the reemployed veteran would have been permitted or required to contribute had the person remained continuously employed by the employer throughout the period of uniformed service.

USERRA generally became effective with respect to reemployments initiated on or after December 12, 1994. However, retirement plans not in compliance with the relevant provisions of USERRA on the date of its enactment (October 13, 1994) have two years to come into compliance.

Under the Code, annual limits are provided on contributions and benefits under certain retirement plans. For example, the maximum amount of elective deferrals that can be made by an individual pursuant to a qualified cash or deferred arrangement in any taxable year is limited to $9,500 in 1996. Certain other rules, such as rules relating to nondiscrimination, coverage, minimum participation, and top-heavy plans, might limit the amount that can be contributed to a plan on behalf of an employee. There is no special provision under present law that permits contributions or deferrals to exceed these limits for a reemployed veteran. Violations of these rules can result in plan disqualification. The Code also imposes certain limits on deductible contributions to retirement plans without any special provision for payments made on behalf of a reemployed veteran.

Reasons for Change

Amendments are needed to conform the Code's qualified retirement plan rules with USERRA.

Proposal

The proposal provides special rules in the case of certain contributions ("make-up contributions") with respect to a reemployed veteran that are made pursuant to USERRA, so as to conform the rules contained in the Code with the rights of reemployed veterans under USERRA. The proposal applies to make-up contributions made by an employer or employee to an individual account plan and to make-up contributions made by an employee to a defined benefit plan that provides for employee contributions.

Under the proposal, a make-up contribution is subject to the generally applicable plan contribution limits and the limit on deductible contributions for the year to which the contribution relates, not for the year in which the contribution is made. The proposal also provides that a plan under which a make-up contribution is made will not be treated as failing to meet the qualified plan nondiscrimination, coverage, minimum participation, or top-heavy rules on account of the contribution. In addition, the proposal provides that certain rules that apply to plan loans will not be violated merely because a plan suspends the repayment of a loan during a period of uniformed service.

The proposal would be effective as of December 12, 1994, the effective date of the relevant USERRA provisions..

ELIMINATION OF SPECIAL VESTING RULE FOR MULTIEMPLOYER PLANS
(Section 1403)

Current Law

The accrued benefits of a collectively bargained employee under a multiemployer retirement plan attributable to employer contributions are not currently required to become nonforfeitable (i.e., "vested") until the employee has completed 10 years of service. If the employee's employment terminates before then, all benefits can be lost. Accrued benefits of all other employees (i.e., employees under all non-multiemployer plans and any noncollectively bargained employees under a multiemployer plan) must vest after five years of service, or after seven years if partial vesting begins after three years.

Reasons for Change

The 10-year vesting schedule for multiemployer plans adds to the complexity of the pension law by providing different vesting schedules for different types of plans and for different people covered by the same plan. In addition, conforming the multiemployer plan vesting rules to the vesting rules for other plans would ensure that workers covered by multiemployer plans would become entitled to pension benefits on the same basis as workers covered by other plans.

Proposal

The special ten-year vesting rule applicable to multiemployer plans under the Code would be repealed. A parallel change to ERISA would be made.

This proposal would be effective for plan years beginning on or after the earlier of (1) the later of January 1, 1997, or the date on which the last of the collective bargaining agreements pursuant to which the plan is maintained terminates, or (2) January 1, 1999, with respect to participants who have at least one hour of service after the effective date

TITLE II -- ERISA PROVISIONS

SUBTITLE A -- EXPANDED PENSION COVERAGE AND SIMPLIFICATION

REPORTING AND FIDUCIARY REQUIREMENTS RELATING TO NATIONAL EMPLOYEE SAVINGS TRUSTS
(Section 2001)

Current Law

Under the Employee Retirement Income Security Act of 1974 (ERISA), certain pension and welfare benefit plans are required to file an annual return/report (the Form 5500 series) regarding their financial condition, investments, and operations. The Form 5500 Series is the primary source of information concerning the operation, funding, assets, and investments of pension and other employee benefit plans. The Form 5500 Series is currently received and processed by the IRS through three designated IRS Service Centers.

Under ERISA, administrators of certain employee pension and welfare benefit plans are required to furnish each participant and beneficiary with a summary plan description (SPD), summaries of material modifications (SMMs) to the SPD and, at specified intervals, an updated SPD. Generally, these documents must also be filed with the Department of Labor. The SPD is intended to provide participants and beneficiaries with important information concerning their plan, the benefits provided by the plan, and their rights and obligations under the plan.

Finally, ERISA sets forth certain fiduciary responsibilities that apply with respect to covered pension and welfare benefit plans. For this purpose, a fiduciary includes, among others, any person who exercises any discretionary control respecting the management or disposition of plan assets. Generally, these rules require that fiduciaries discharge their duties prudently; in accordance with plan documents; that they diversify plan assets; and that the assets of the plan are used solely to provide benefits to participants and defray necessary expenses of the plan.

Reasons for Change

The tax-favored employer retirement plans currently available under the Internal Revenue Code (Code) have not been sufficiently successful in attracting small employers. The administrative cost and complexity associated with traditional qualified retirement plans often discourages small employers from sponsoring these plans.

Proposal

As described in greater detail in Title I, Chapter 1 of this legislation, the proposal would create a new, simple retirement plan for employers with 100 or fewer employees. The new plan would be known as the National Employee Savings Trust, or "NEST."

This section describes the special ERISA Title I rules applicable to the NEST.

Application of ERISA fiduciary rules: Under the NEST, the employer would be relieved from fiduciary liability in certain circumstances. After an applicable period, there would be no employer liability resulting from the (A) designation of the trustee or issuer of the account or (B) the manner in which the assets in the account are invested. The relief from fiduciary liability would apply after the earlier of (1) an affirmative election by the employee with respect to the initial investment of any contributions, (2) a rollover of contributions from an employee's NEST account to another IRA, or (3) one year after the individual's NEST account is established, provided that the participant has been properly notified that he or she had a right to direct investments, and a penalty-free right to roll over the NEST contributions. The assets held in the NEST would cease to be plan assets when rolled over to another IRA or otherwise distributed as benefits. Also, employers would be required to forward withheld participant contributions to the NEST trustee under the same rules applicable to section 401(k) plans.

Reporting Requirements: An employer maintaining a NEST would not be subject to any ERISA reporting requirements (e.g., Form 5500 filing). However, the NEST trustee or custodian would be required to report NEST contributions on Form 5498, on which IRA contributions are reported.

Disclosure: Employees would be required to be notified annually in writing of their rights under the plan, including, for example, the right to a matching contribution and information from the NEST trustee or issuer. Similarly, if an employer wanted to switch between safe harbor contribution formulas, the employer would be required to notify eligible employees which formula would be used for a year within a reasonable period of time before the beginning of the annual election period. (Employee elections to defer would occur in the last 60 days of each calendar year.)

ERISA SUMMARY PLAN DESCRIPTION FILING REQUIREMENTS
(Section 2002)

Current Law

Under ERISA, administrators of employee pension and welfare benefit plans are generally required to furnish each participant and beneficiary with a summary plan description (SPD), summaries of material modifications (SMMs) to the SPD and, at specified intervals, an updated SPD. These documents generally must also be filed with the Department of Labor (DOL). Filed SPDs, SMMs, and updated SPDs are required to be made available for public disclosure. These requirements are administered by the DOL's Pension and Welfare Benefits Administration (PWBA). The SPD is intended to provide participants and beneficiaries with important information concerning their plan, the benefits provided by the plan, and their rights and obligations under the plan. A penalty of up to $100 per day may be imposed by a court for failure to provide the participant or beneficiary with the SPD or SMM.

Reasons for Change

The primary purpose of having SPDs filed with the DOL is to have them available for participants and beneficiaries who are unable or reluctant to request them from their plan administrators. However, because SMMs summarizing plan changes are not required to be filed with DOL until 210 days after the end of the plan year, there is little, if any, certainty that the information on file with the DOL at any given point in time is up-to-date.

PWBA annually receives approximately 250,000 SPD and SMM filings. Although PWBA's cost for maintaining a filing, storage, and retrieval system for SPDs is relatively small (approximately $52,000 annually), compliance with the SPD filing requirements costs plans approximately $2.5 million annually, in addition to an annual imposition of an estimated 150,000 burden hours. On average, PWBA receives requests annually for about 2 percent of the filed SPDs. Many of the requests for SPDs come from researchers and others who are not plan participants and beneficiaries. While there is some limited benefit from the Federal government receiving and storing SPDs, the costs to the public and plans outweigh the benefits. This conclusion is consistent with the findings of the National Performance Review.

Proposal

The proposal would amend ERISA to eliminate the requirement that SPDs and SMMs be filed with the DOL. It would, however, authorize the DOL to obtain SPDs and other relevant documents from plan administrators for purposes of responding to individual requests or monitoring compliance with the SPD and SMM requirements. A plan administrator would be subject to a civil penalty of no more than $100 per day (up to a maximum of $1,000 per request) for failure to furnish the documents requested by the DOL within 30 days. The elimination of the SPD and SMM filing requirement would substantially reduce costs and burdens for public and private plan administrators, while preserving the ability of the DOL to assist participants who are unable or reluctant to request SPDs from their plan administrators.

This provision would be effective for SPDs and SMMs that otherwise would be required to be filed with the DOL on or after the date of enactment.

INVESTMENT OF INDIVIDUAL RETIREMENT ACCOUNTS IN QUALIFIED STATE PREPAID TUITION PROGRAMS
(Section 2003)

Current Law

Some States currently offer prepaid tuition programs to help families finance higher education. Certain IRAs constitute ERISA plans.

Reasons for Change

Some taxpayers may wish to invest IRA funds in State prepaid tuition programs to pay higher education expenses and may want assurance that such investments do not constitute prohibited transactions under ERISA. Another provision of this Act proposal amends the Internal Revenue Code to expressly permit IRAs to be invested in qualified State prepaid tuition program instruments, to the extent provided by the Secretary of the Treasury.

Proposal

The proposal makes a conforming change to Title I of ERISA by explicitly providing that IRA investments in qualified State prepaid tuition program instruments that meet the Code requirements would not be prohibited transactions.

SUBTITLE B -- PORTABILITY

PBGC MISSING PARTICIPANT PROGRAM
(Section 2011)

Current Law

When a qualified retirement plan is terminated, there may be plan participants who cannot be located. If the plan is a defined benefit plan covered by the PBGC, the plan administrator must generally distribute plan assets by purchasing irrevocable commitments from an insurer to satisfy all benefit liabilities. If the plan is a defined contribution plan or other plan not covered by the PBGC, plan assets still must be distributed to participants before the plan is considered terminated.

Because of the problems that plan administrators and participants may face under these rules when plan participants cannot be located, the Retirement Protection Act of 1994 (RPA) provided special rules for the payment of benefits with respect to missing participants (including benefits for beneficiaries of deceased participants) under a terminating single-employer defined benefit plan covered by the PBGC. The rules require the plan administrator to (1) transfer the missing participant's designated benefit to the PBGC or purchase an annuity from an insurer to satisfy the benefit liability, and (2) provide the PBGC with such information and certifications with respect to the benefits or annuity as the PBGC may specify.

Reasons for Change

As currently enacted, these RPA rules apply only to single-employer defined benefit plans that are covered by PBGC. Yet other defined benefit plans, as well as defined contribution plans, face similar problems when they terminate and cannot locate missing participants.

Proposal

The PBGC's program for missing participants would be expanded to apply to multiemployer defined benefit plans, to defined contribution plans and to defined benefit plans not covered by PBGC (such as plans of small professional service employers). The program would not apply to governmental plans or to church plans not covered by the PBGC. If a plan covered by the new program has missing participants when the plan terminates, it would be able to transfer the missing participants' benefits to the PBGC along with related information. If the benefit of a missing participant is not transferred to the PBGC or to another plan, the plan administrator would give the PBGC information with respect to the missing participant's benefit. This would provide administrators of terminating plans an entity (i.e., the PBGC) that would accept missing participants' benefits and would provide missing participants with a central repository for locating their benefits after a plan has been terminated.

This proposal would be effective with respect to distributions from terminating plans that occur after the PBGC has adopted final regulations implementing the provision.

ELIMINATION OF SPECIAL VESTING RULE FOR MULTIEMPLOYER PLANS
(Section 2012)

Current Law

The accrued benefits of a collectively bargained employee under a multiemployer pension plan attributable to employer contributions are not currently required to become nonforfeitable (i.e., "vested") until the employee has completed 10 years of service. If the employee's employment terminates before then, all such benefits can be lost. Accrued benefits of all other employees (i.e., employees under all non-multiemployer plans and any noncollectively bargained employees under a multiemployer plan) must vest after five years of service, or after seven years if partial vesting begins after three years.

Reasons for Change

The 10-year vesting schedule for multiemployer plans adds to the complexity of the pension law by providing different vesting schedules for different types of plans and for different people covered by the same plan. In addition, conforming the multiemployer plan vesting rules to the vesting rules for other plans would ensure that workers covered by multiemployer plans would become entitled to pension benefits on the same basis as workers covered by other plans.

Proposal

The special 10-year vesting rule applicable to multiemployer plans under ERISA would be repealed. A parallel change to the Internal Revenue Code would be made.

This proposal would be effective for plan years beginning on or after the earlier of (1) the later of January 1, 1997, or the date on which the last of the collective bargaining agreements pursuant to which the plan is maintained terminates, or (2) January 1, 1999, with respect to participants who have at least one hour of service after the effective date.

VETERANS' REEMPLOYMENT
(Section 2013)

Current Law

Under the Uniformed Services Employment Rights Act of 1994 ("USERRA"), which revised and restated the Federal law protecting veterans' reemployment rights, a returning veteran generally is entitled to the restoration of certain pension, profit sharing and similar benefits that would have accrued but for the employee's absence due to the military service. USERRA generally provides that service in the uniformed services is considered service with the employer for retirement plan benefit accrual purposes. USERRA also provides that the reemployed veteran is entitled to any accrued benefits that are contingent on the making of, or derived from, employee contributions or elective deferrals, but only to the extent the reemployed veteran makes payment to the plan with respect to such contributions or deferrals.

USERRA generally became effective with respect to reemployment initiated on or after December 12, 1994. However, retirement plans not in compliance with the relevant provisions of USERRA on the date of its enactment (October 13, 1994) have two years to come into compliance.

The Internal Revenue Code and ERISA impose restrictions on loans from retirement plans to certain participants. However, neither ERISA nor USERRA has any special provision concerning a suspension of loan repayment by an individual who is absent from work during a period of uniformed service.

Reasons for Change

Another provision of this Act would amend the Internal Revenue Code to conform the Code's qualified retirement plan rules with USERRA and to provide that certain rules applicable to plan loans will not be violated merely because the plan suspends the repayment of a loan during a period of uniformed service. The amendment would make a conforming change to Title I of ERISA concerning the suspension of plan loan repayments.

Proposal

The proposal provides that certain rules that apply to plan loans in ERISA will not be violated merely because a plan suspends the repayment of a loan during a period of uniformed service. This proposal would be effective as of December 12, 1994, the effective date of the relevant USERRA provisions.

SUBTITLE C -- ENHANCED SECURITY
CHAPTER 1 -- GENERAL PROVISIONS

MULTIEMPLOYER PLAN BENEFITS GUARANTEED
(Section 2021)

Current Law

The Pension Benefit Guaranty Corporation guarantees benefits of workers in multiemployer plans. The monthly guarantee is equal to the participant's years of service multiplied by the sum of (i) 100 percent of the first $5 of the monthly benefit accrual rate, and (ii) 75 percent of the next $15 of the accrual rate.

Reasons for Change

The level of benefits guaranteed by the PBGC under the multiemployer program is modest and has not increased since 1980. For a retiree with 30 years of service, the maximum guaranteed annual benefit is $5,850. This compares to a maximum guaranteed annual benefit of about $31,700 under the PBGC's single-employer program, a maximum that is adjusted each year to reflect changes in the social security wage index.

Proposal

The proposal adjusts the amount guaranteed in multiemployer plans to account for changes in the social security wage index since 1980. Under the proposal, the PBGC would guarantee a monthly benefit equal to the participant's years of service multiplied by the sum of (i) 100 percent of the first $11 of the monthly benefit accrual rate, and (ii) 75 percent of the next $33 of the accrual rate. The proposed change would increase the maximum annual guarantee for a retiree with 30 years of service to $12,870.

The proposal would be effective for plans that have not received assistance payments from the PBGC during the 1-year period ending on the date of enactment.

REVERSION REPORT
(Section 2022)

Current Law

Under present law, defined benefit pension plan assets generally may not revert to an employer prior to the termination of the plan and the satisfaction of all plan liabilities. Any plan assets that revert to the employer upon such termination are includable in the gross income of the employer and subject to an excise tax. Employers that terminate defined benefit pension plans covered by the Pension Benefit Guaranty Corporation must report the termination to the PBGC and notify plan participants of their benefits.

Reasons for Change

During the 1980s, over $20 billion of pension assets reverted to corporations. The excise taxes subsequently imposed on pension reversions successfully curtailed these activities. However, the President and the Congress need to be informed regularly of any increase in reversions in order to review in a timely manner whether current law needs to be strengthened.

Proposal

The proposal requires the Secretary of Labor, as Chairman of the PBGC, to report on reversion activity annually to the President and the Congress.

FULL FUNDING LIMITATION FOR MULTIEMPLOYER PLANS
(Section 2023)

Current Law

An employer's annual deduction for contributions to a defined benefit plan is generally limited to the amount by which 150 percent of the plan's current liability (or, if less, 100 percent of the plan's accrued liability) exceeds the value of the plan's assets. The 150 percent-of-current-liability limit restricts the extent to which an employer can deduct contributions for benefits that have not yet accrued.

Defined benefit plans are required by ERISA to have an actuarial valuation no less frequently than annually.

Reasons for Change

An employer has little, if any, incentive to make "excess" contributions to a multiemployer plan. The amount an employer contributes to a multiemployer plan is fixed by the collective bargaining agreement, and a particular employer's contributions are not set aside to pay benefits solely to the employees of that employer.

Proposal

The 150 percent limit would be eliminated for multiemployer plans. Therefore, the annual deduction for contributions to a multiemployer plan would be limited to the amount by which the plan's accrued liability exceeds the value of the plan's assets. In addition, actuarial valuations would be required under ERISA no less frequently than every three years for multiemployer plans. Parallel changes would be made to the Internal Revenue Code.

These provisions would be effective for years beginning after December 31, 1996.

PROHIBITED TRANSACTIONS
(Section 2024)

Current Law

A "prohibited transaction" under section 406 is generally any transaction between a plan and a person who is considered a "party in interest" with respect to the plan. Unless exempt by statute or by an individual or class exemption or subject to an excise tax under section 4975 of the Internal Revenue Code, a prohibited transaction gives rise to a civil penalty (imposed on the party in interest) equal to 5 percent of the amount involved in the transaction. If the transaction is not corrected, an additional 100 percent civil penalty may be imposed.

Reasons for Change

A 10 percent penalty should be more effective in discouraging prohibited transactions than the current penalty of 5 percent.

Proposal

The proposal would increase the initial civil penalty from 5 percent to 10 percent, effective for transactions occurring after December 31, 1996.

A parallel change would be made to the Internal Revenue Code.

SUBSTANTIAL OWNER RULES RELATING TO PLAN TERMINATIONS
(Section 2025)

Current Law

ERISA contains very complicated rules for determining the benefits guaranteed by the Pension Benefit Guaranty Corporation (PBGC) for an individual who owns more than ten percent of a business (a "substantial owner") and who is a participant in the business's terminating plan. These rules were designed to prevent a substantial owner from establishing a plan, underfunding it, and terminating it in order to receive benefits from the PBGC. Under the rules, the PBGC guarantee with respect to a participant who is not a substantial owner is generally phased in over five years from the date of the plan's adoption or amendment. However, for a substantial owner, the guarantee is generally phased in over 30 years from the date the substantial owner begins participation in the plan. The substantial owner's benefit under each amendment within the 30 years before plan termination is separately phased in. A substantial owner's guaranteed benefit also cannot exceed twice the amount guaranteed under the original plan provisions. In addition, special rules apply for allocating assets with respect to substantial owners upon plan termination.

Reasons for Change

The substantial owner phase-in rules are complex and difficult to apply because of the need to obtain plan documents going back up to 30 years. The reduced guarantee for employees with less than a majority ownership interest penalizes employees who may have little, if any, control over plan benefit levels or funding decisions. It also unfairly penalizes substantial owners who granted themselves low benefits when they entered the plan. The substantial owner allocation of asset rules are confusing and complex to administer.

Proposal

The same five-year phase-in that currently applies to a participant who is not a substantial owner would apply to a substantial owner with less than a 50 percent ownership interest. For a substantial owner with a 50 percent or more ownership interest (a "majority owner"), the phase-in would depend on the number of years the plan has been in effect, rather than on the number of years the owner has been a participant and the initial plan benefit. Specifically, the guaranteeable plan benefit for a majority owner would be 1/30 for each year the plan has been in effect and the restriction that limits a substantial owner's guaranteed benefit to twice the amount guaranteed under the original plan provisions would be eliminated. This approach would eliminate the need for computations based on documents that are up to 30 years old. A majority owner's guaranteed benefit would be limited so that it could not be more than the amount that would be guaranteed under the regular five-year phase-in applicable to other participants. In addition the rules for allocating plan assets upon plan termination would be changed to treat substantial owners, other than majority owners, in the same manner as other participants and to simplify, in certain cases, the allocation with respect to majority owners.

The proposal would be effective for plan terminations for which notices of intent to terminate are provided (or for which proceedings for termination are instituted by the PBGC) on or after the date of enactment.

CHAPTER 2 -- ERISA ENFORCEMENT

REPEAL OF LIMITED SCOPE AUDIT
(Section 2032)

Current law

Current law generally requires the administrator of certain ERISA-covered plans with 100 or more participants to engage an independent public accountant to conduct an audit of the financial statements and of certain required schedules contained in the annual report to determine whether the financial statements are prepared and presented in accordance with Generally Accepted Accounting Principles (GAAP). Section 103(a)(3)(C) of ERISA contains the so-called "limited scope exemption" which allows the exclusion of assets which are held by certain regulated financial institutions (e.g., banks or similar institutions, or insurance companies) from the scope of the required financial audit if certain conditions are satisfied.

Reasons for Change

The limited scope audit provision has resulted in nearly half of pension plan assets, amounting to approximately 1 trillion dollars, not being subject to audit.

Proposal

The proposal would repeal the limited scope exemption. The provision, by eliminating the statutory scope limitation, would require inclusion of plan assets which are held by certain regulated financial institutions within the accountant's audit of the plan. This provision is not meant to require that the plan's accountant duplicate the work of the independent accountant who audits the financial institution's books and records. It is expected that, generally, the plan's accountant will encourage the use of Reports on the Processing of Transactions Service Organizations under American Institute of Certified Public Accountants Statement on Auditing Standards No. 70. Under this "single audit approach," affected banks and other institutions would instruct their independent auditors to prepare a special report that, in essence, would speak to the reliability of information generated by the bank and other financial institutions with respect to their actions regarding plan assets. Presently, plan auditors routinely obtain SAS 70 reports in connection with their full scope audits of plans. Only about half of plans subject to the audit requirement use limited scope audits. The remaining plans conduct full scope audits and many of those are already utilizing the single audit approach.

This "single audit approach" would fulfill the purposes of the audit requirement without imposing the additional cost of independently reviewing the financial institution's records. At the same time, accountants would no longer be required to disclaim an opinion on their audit reports Such a report fails to provide assurance regarding the security of plan assets.

This change would apply for plan years beginning on or after January 1 of the calendar year immediately following the date of enactment.

REPORTING AND ENFORCEMENT REQUIREMENTS FOR EMPLOYEE BENEFIT PLANS
(Section 2033)

Current Law

Under current law, there is no specific duty for an administrator of an employee benefit plan, or an accountant who conducts a plan audit, to disclose promptly to the Secretary information indicating that a crime involving the plan, such as embezzlement, bribery, or kickbacks, may have occurred. Termination of an accountant from an auditing engagement is reportable when annual reports of plans with 100 or more participants are filed with the Secretary.

Reasons for Change

While plan accountants and auditors are often the first line of defense against fraud, current rules create a time lag between the detection of serious irregularities (i.e., embezzlement, bribery or kick backs) and the filing of an annual report with the government. This bill would require both plan administrators and accountants auditing plans who discover serious fraud or other egregious violations of law to promptly report them to the Department of Labor.

Proposal

Reporting of certain information: This section would require the administrator of an employee benefit plan to notify the Secretary of Labor within five business days whenever the administrator has determined that there is evidence that an irregularity may have occurred with respect to the plan, or has received notice from the accountant that the accountant has similarly determined that there is evidence that an irregularity may have occurred. The administrator would also be required to furnish a copy of such notification to the accountant engaged to audit the plan's financial statements.

An accountant engaged to audit a plan's financial statements would be required to notify the plan administrator within five business days when the accountant has determined that there is evidence that an irregularity may have occurred with respect to the plan. If the accountant has not received a copy of the administrator's notification to the Secretary within the required five-business-day period, the accountant must furnish the Secretary a copy of its notification to the plan administrator within the next business day following such failure to receive notice. No change in auditing procedures would be required by virtue of this notification standard.

Under the bill, an administrator who gets notice from an accountant would report the irregularity to the Department of Labor without being required to verify the information provided by the accountant. Administrators who independently discover evidence of serious problems, like the ones listed in the bill, can fairly be expected to recognize them in exercising their normal responsibilities as ERISA fiduciaries.

At the same time, this standard does not require a report to the Department whenever the administrator or accountant receives any information concerning a possible irregularity. For example, if for some reason the plan administrator believes that the person providing the information is not trustworthy, the administrator would not be expected to file a report.

If the accountant determines that there is evidence that the irregularity may have involved an individual who is the plan administrator or a senior official of the plan administrator, the accountant shall not notify the plan administrator but shall instead notify the Secretary within five business days. It should be noted that accountants already have a responsibility to inform clients, including plan administrators, if they discover during the course of an audit that a crime or other irregularity may have occurred as a result of generally accepted auditing standards.

The requirement to report within five business days is realistic for reporting such serious violations. It should be noted that the "Private Securities Ligation Reform Act of 1995" imposes similar reporting requirements where an audit committee has not acted on an accountant's report.

For purposes of the notification requirements in the bill, the term "irregularity" means a theft, embezzlement, extortion, bribery, kickback, or criminal reporting or recordkeeping violation described in 18 U.S.C. §§ 664, 1951, 1954, and 1027 or any comparable provisions of State criminal law involving the plan or a violation of the criminal provisions of section 411, 501, and 511 of Title I of ERISA. Under the bill, however, the term "irregularity" does not include any acts involving less than one thousand dollars unless the accountant has reason to believe that the violations may bear on the integrity of plan management. It is not intended that *de minimis* violations unrelated to the integrity of the fund or plan management be reported. This exclusion ensures that only serious irregularities are to be reported.

The bill provides a "safe harbor" to protect from liability accountants and plan administrators who report an irregularity, provided that the reports were made in good faith.

Reporting of Auditor Termination: If the administrator terminates the accountant's engagement for auditing services, the administrator must, within five business days of the termination, notify the Secretary of the termination and of the reasons for the termination, and furnish a copy of the notification to the accountant. If the accountant has not received a copy of the notification, or disagrees with the reasons for the termination, the accountant shall notify the Secretary within ten business days after the termination, giving the reasons for the termination.

Civil Penalty: This proposal also amends ERISA to provide that the Secretary may impose a civil penalty of up to $100,000 against any plan administrator who violates any requirement to report information required under this proposal. The penalty also applies to any accountant who knowingly and willfully violates any requirement to report information to the Secretary. The penalty applies separately to each accountant and administrator in any violation of these requirements. For example, if both were involved in one violation, both the accountant and the administrator would be subject to a penalty of up to $100,000 each. Noncompliance with the new reporting requirements could, in egregious situations, also subject plan administrators and accountants to criminal penalties

under ERISA. Because a willful violation of the provisions may result in criminal prosecution, it is expected that the Secretary of Labor will consult with the Department of Justice in drafting regulations to the extent appropriate.

It is expected however, that the civil penalty provisions will be utilized primarily to ensure compliance with the new reporting rules, and that implementing regulations would provide for abatement or waiver of penalties in appropriate situations.

The amendments made by this section shall apply with respect to any irregularity or termination of engagement only if the five-day period described in such amendments commences at least 90 days after the date of enactment.

ADDITIONAL REQUIREMENTS FOR QUALIFIED PUBLIC ACCOUNTANTS
(Section 2034)

Current law

ERISA requires that certain plans obtain audits of the financial statements included in their annual reports. This audit is required to be conducted by a "qualified public accountant" as defined by section 103(a)(3)(D). The definition incorporates public accountants certified or licensed by a regulatory authority of a State or certified by the Secretary of Labor.

Reasons for Change

Federal law enforcement agencies, including the Pension and Welfare Benefits Administration and the Inspector General, as well as reviewer determinations made by the General Accounting Office on this issue, have found that current ERISA audits do not consistently meet professional standards. The definition of "qualified public accountant" contained in the statute qualifies accountants solely on the basis of licensing or certification. Accountants in many states need not participate in continuing quality control and education programs to assure the quality of their work remains sufficient to be licensed or that they are qualified to conduct employee benefit plan audits.

There is no external quality control review requirement for qualified public accountants under current law. Except with respect to accountants who practice in States without licensing requirements, ERISA does not grant the Secretary authority to impose additional qualifications or requirements on accountants necessary to protect the integrity of plan assets.

Proposal

This proposal amends ERISA's definition of "qualified public accountant" to include regulatory requirements and qualifications that the Secretary deems necessary to ensure the quality of plan audits. This proposal includes a specific requirement that, to be a qualified public accountant, a person must have in operation an appropriate internal quality control system and have participated in an external quality control review of the accountant's accounting and auditing practices relevant to employee benefit plans within the three-year period prior to engagement to conduct an audit. In addition, the accountant must also have completed, within the two-year period immediately preceding such engagement, at least 80 hours of continuing education or training which contributes to the accountant's professional proficiency, at least 20 hours of which have been completed during the one-year period immediately preceding the engagement and at least 16 hours of which relate to employee benefit plan matters, or has completed such continuing education or training requirements as the Secretary may prescribe in regulations. The external quality control reviews must be performed in accordance with the requirements of the review programs of recognized auditing standard-setting bodies, as determined by the Secretary in regulations.

Any such review must include the review of an appropriate number of plan audits in relation to the scale of the qualified public accountant's auditing practice, but in no event less than one, unless the accountant has conducted no employee plan audits.

Except for the Secretary's authority to issue additional regulatory requirements, the provisions of this section are effective with respect to plan years beginning on or after three years from the date of enactment of this Act. This creates a minimum three-year transition period which provides an opportunity for the completion of initial external quality control to be conducted by recognized auditing standard-setting bodies. The Secretary's authority to issue regulations is effective upon enactment, although the regulation would not be effective until the statutory provision became effective.

CLARIFICATION OF FIDUCIARY PENALTIES
(Sections 1502 and 2035)

A. MODIFICATION OF PROHIBITION OF ASSIGNMENT OR ALIENATION

Current Law

ERISA and the Internal Revenue Code generally prohibit the assignment and alienation of pension benefits. As a result of *dicta* in the Supreme Court's opinion in Guildry v. Sheet Metal Workers National Pension Fund, 493 U.S. 365 (1990) that "courts should be loath to announce equitable exceptions to legislative requirements or prohibitions that are unqualified by statutory text", courts have been divided in their interpretation of this prohibition. Some courts have ruled that there is no equitable exception in ERISA for offset of a participant's pension benefit to make a plan whole for losses resulting from a fiduciary breach. Other courts have ruled that nothing in ERISA's prohibition of assigning or alienating pension benefits was intended to limit the remedies under ERISA and that the prohibition should be properly read only to shield participants' interests in pension plans from third-party creditors.

Reason for Change

The Administration believes that, because of the conflicting judicial decisions, this is an area that needs clarification.

Proposal

This proposal clarifies that the provisions of ERISA and the Internal Revenue Code, which prohibit the assignment and alienation of pension benefits, would not be violated when the participant's accrued benefits in the plan are offset against the amount owed to the plan by the participant as a result of a breach of fiduciary duty to the plan or criminality involving the plan. An offset will be treated as a taxable distribution to the participant.

This section applies only to amounts required to be paid under: criminal judgments; civil judgments for violations of the fiduciary responsibility provisions of ERISA; or settlement agreements of such violations with the Secretary of Labor or the PBGC. The participant's spouse retains the right to receive the minimum survivor annuity protection to which the spouse is entitled, unless the spouse consents to the offset or is required to pay an amount to the plan under the judgment or settlement agreement.

B. CIVIL PENALTIES FOR BREACH OF FIDUCIARY RESPONSIBILITY

Current Law

Section 502(l) was added to ERISA by the Omnibus Budget Reconciliation Act of 1989. In its current form, section 502(l) requires the Secretary of Labor to assess a civil penalty against (1)

a fiduciary who breaches a fiduciary responsibility under, or commits a violation of, part 4 of Title I of ERISA, or (2) any other person who knowingly participates in such a breach or violation. The penalty is equal to 20 percent of the "applicable recovery amount" that is paid pursuant to a settlement agreement with the Secretary or that a court orders to be paid in a judicial proceeding brought by the Secretary to enforce ERISA's fiduciary responsibility provisions. The Secretary may waive or reduce the penalty only if the Secretary finds in writing that either (1) the fiduciary or other person acted reasonably and in good faith, or (2) it is reasonable to expect that the fiduciary or other person cannot restore all the losses without severe financial hardship unless the waiver or reduction is granted.

Reason for Change

Since its enactment, section 502(l) has not resulted in the collection of significant revenues and has been extremely difficult to administer. The principal problems are due to the mandatory nature of the penalty and the requirement that there be a court order or a settlement agreement. The waiver or reduction provision is very narrow, and affords the Secretary little opportunity to adjust the penalty based on the particular circumstances of a case. Especially in the settlement context, the penalty may have the effect of paying money to the government that would otherwise be available to offset a plan's losses. Moreover, the requirement of a settlement agreement produces difficult questions concerning whether a particular payment was recovered pursuant to a settlement agreement. If the fiduciary or other person repays the losses, but insists that there was no settlement agreement, the Secretary may have a difficult time establishing the existence of a settlement agreement. As a result, the penalty actually creates a disincentive for parties to settle with the Secretary. The existing provision penalizes the fiduciary who settles with the Department and restores a plan's losses, but it imposes no penalty on a similarly situated person who makes no payment or who makes a payment without entering into a settlement with the Department.

Proposal

The proposal removes the current disincentive to settlement and encourage parties to quickly settle claims of violations that the Department brings to their attention. The proposal makes two principal changes to the current statutory scheme of section 502(l). First, section 502(l) is amended to make the assessment of the penalty discretionary with the Secretary of Labor, rather than mandatory. This change will allow the Secretary to refrain from imposing the penalty in certain cases as well as to assess a penalty of less than 20 percent of the applicable recovery amount. Second, it eliminates the requirement of a settlement agreement. The applicable recovery amount would be any amount recovered by a plan or by a participant or beneficiary more than 30 days after the fiduciary's or other person's receipt of a written notice of the violation from the Department of Labor. This 30-day grace period, which the Secretary can extend, would serve as a strong incentive for parties to quickly reach a settlement with the Secretary to avoid imposition of the penalty. Payments made after the grace period, whether they are made pursuant to a settlement agreement, or simply to discourage the Department from bringing a legal action, would be subject to the penalty, as would amounts recovered pursuant to a court order.

The proposal also amends section 502(l) to clarify that the term "applicable recovery amount" includes payments by third parties that are made on behalf of the relevant fiduciary or other person. These changes allow the Department to assess the penalty against all fiduciaries and other persons who are liable for the amount that is recovered, including those who did not actually pay. These changes also prevent avoidance of the penalty by having an unrelated third party pay the recovery amount.

The proposal adds a new provision which is designed to avoid a problem of applying the penalty to certain violations that begin before the effective date of enactment but that continue afterwards, such as violations involving leases, loans and service agreements. Under the current version of section 502(l), there is a need to make complex determinations regarding how much of the applicable recovery amount for such continuing violations should be attributed to the post enactment part of the violation, which is the only part of the violation with respect to which the penalty may be assessed. After giving fiduciaries six months to undo continuing violations without application of the amendments, provision treats all such violations as having begun after the effective date of the amendments for purposes of determining the applicable recovery amount.

Finally, another new provision is added to section 502(l). It expressly provides that, when a penalty is contested, Administrative Law Judges will have the authority to decide both the existence of the underlying violation and the applicable recovery amount.

This section applies to any breach of fiduciary responsibility or other violation of part 4 of Title I of ERISA occurring on or after enactment.

TITLE III -- FEDERAL THRIFT SAVINGS PLAN

IMMEDIATE PARTICIPATION IN THE THRIFT SAVINGS PLAN FOR FEDERAL EMPLOYEES
(Section 3001)

Current Law

The Thrift Savings Plan (TSP) is a retirement savings and investment plan for Federal and Postal employees. It offers employees the same type of before-tax savings and tax-deferred investment earnings that many private corporations offer their employees under section 401(k) plans.

The TSP contribution rules vary for employees depending on their coverage under the Federal Employees' Retirement System (FERS) or the Civil Service Retirement System (CSRS). FERS employees may contribute up to 10 percent of basic pay each pay period. If they make employee contributions, they also receive agency matching contributions according to a statutory schedule. Whether they contribute or not, they receive agency automatic contributions equal to 1 percent of their basic pay each pay period.

CSRS employees may contribute up to 5 percent of basic pay each pay period but do not receive any agency contributions.

Eligible employees can sign up to contribute to the TSP only during two semi-annual election periods established by law. The effect of this and other statutory limitations is that certain waiting periods apply before employees may make employee contributions or receive agency automatic (1 percent) and agency matching contributions.

Newly hired employees are first eligible to participate in the second election period after being hired under FERS. Thus, these employees must wait from six to twelve months, depending on their date of hire, before they may contribute their own funds or receive agency contributions. Rehired FERS or CSRS employees who were previously eligible to participate in the TSP program become eligible in the first election period following their rehire and, thus, wait up to six months.

Reasons for Change

Allowing workers to begin contributing to the TSP immediately makes it more likely that workers will get into or continue the habit of saving for retirement through payroll deduction. Workers who are not allowed to contribute to the TSP immediately lose valuable tax-savings for the 6 to 12 months they are not allowed to contribute -- amounts that cannot be made up later by larger contributions.

Proposal

All waiting periods for employee contributions to the TSP would be eliminated for new hires and rehires. Workers who are hired or rehired would be eligible to contribute immediately. Agency matching and automatic (1 percent) contributions would remain subject to the waiting periods in current law .

SURVIVOR PROTECTION FOR SURVIVING AND FORMER SPOUSES OF FORMER FEDERAL EMPLOYEES
(Section 3002)

Current Law

Surviving spouses of Federal employees and retirees are generally entitled to receive a survivor annuity, and former spouses may also be eligible to receive survivor benefits, if the divorce court determines they should. However, under the Civil Service Retirement System (CSRS -- applicable to most employees hired before 1983), when an employee leaves Federal government employment before being eligible for an immediate annuity, and then dies before becoming eligible for a deferred annuity (at age 62), no survivor annuity can be paid (except to a survivor of a former Member of Congress). This is unlike the Federal Employees' Retirement System (FERS -- applicable to most employees hired since 1983), where a surviving spouse or former spouse of an employee who left Federal government employment with potential eligibility for a deferred annuity can receive a survivor benefit even if the former employee dies before reaching eligibility for the deferred annuity.

Reasons for Change

The lack of survivor protection for surviving spouses and former spouses of former employees who die while eligible for a deferred annuity under CSRS is a significant gap in income protection for a small but important group. The availability of such benefits under FERS (and for spouses of Members of Congress under CSRS) demonstrates the feasibility of providing such income protection.

Proposal

The proposal, like FERS, would provide a benefit for surviving spouses and former spouses of a former employee who died while eligible for a deferred annuity under CSRS. The surviving spouses (and former spouses, if awarded by the divorce decree) would be able to elect to receive either (1) 55 percent of the former employee's deferred annuity, commencing when the employee's deferred annuity would have commenced, had the employee lived; (2) the actuarial equivalent of (1), but commencing at the time of the former employee's death; or (3) a refund of the former employee's retirement contributions.

PAYMENT OF LUMP SUM CREDIT FOR FORMER SPOUSES OF FEDERAL EMPLOYEES
(Section 3003)

Current Law

Under current law, when an employee, former employee, or annuitant dies, any contribution to his or her credit in the Civil Service Retirement and Disability Fund must be paid to whomever the employee or annuitant designated to receive that contribution. If no designation was made, there is a statutory order of precedence beginning with the surviving spouse. There is no provision in law that permits a court order to interfere with these arrangements. If, for instance, an employee agreed in a divorce settlement to designate a former spouse to receive these funds, and later designated another individual, current law would require payment of the funds to the other individual.

Reasons for Change

The contributions on deposit in the Civil Service Retirement and Disability Fund can constitute a significant portion of the marital property, and there is no reason these funds should be beyond the reach of a divorce proceeding or, worse, be subject to being redirected in defiance of a judgment of a divorce court.

Proposal

This proposal would establish that the payment of contributions to the employee's credit in the Retirement Fund would be subject to the judgment of a divorce court, in the same way the employee's annuity and survivor benefits are. Thus, a proper court order on file with the Office of Personnel Management would supersede any designation of beneficiary by the employee or annuitant.

TITLE IV -- CONFORMING RAILROAD RETIREMENT BENEFITS WITH SOCIAL SECURITY

CONFORMING RAILROAD RETIREMENT BENEFITS WITH SOCIAL SECURITY
(Sections 4001 - 4006)

Current Law

Annuities under the Railroad Retirement Act include a tier 1 benefit, which is generally equal to the benefit that would have been payable under the Social Security Act if all of the employee's service had been covered under the Social Security Act. The cost of these social security equivalent benefits is borne by the financial interchange between the railroad retirement and social security systems. Under the financial interchange, the social security trust funds receive, in effect, the tax revenues from railroad employment equal to the amount that would have been collected under the Federal Insurance Contributions Act, and the railroad retirement trust funds receive from the social security trust funds an amount equal to the benefits that would have been paid under the Social Security Act had the railroad employment been covered under that Act.

Although the railroad retirement trust funds receive funds based on the amount of benefits that would have been paid under the Social Security Act if railroad employment had been covered by that Act, the Railroad Retirement Act does not provide benefits for certain classes of persons who would have received benefits under the Social Security Act. Accordingly, the funds transferred from the social security trust funds exceed the amount of social security equivalent benefits actually paid under the Railroad Retirement Act. The largest group of persons who would receive benefits under the Social Security Act but who do not directly receive benefits under the Railroad Retirement Act are children of living employee beneficiaries. Another sizable group of persons who do not receive benefits under the Railroad Retirement Act includes survivors where a residual lump sum benefit (i.e., a lump sum paid in lieu of future benefits under the Railroad Retirement Act) has been paid.

Reasons for Change

Under current law, the balance in the Social Security Equivalent Account, the account from which railroad retirement social security equivalent benefits are paid, is increasing and the "surplus" in that account will not be used to pay social security equivalent benefits. These funds should be used to pay social security equivalent benefits in the same amounts and to the same persons as would have been the case under the Social Security Act.

Proposal

The difference in entitlement to social security equivalent benefits under the Railroad Retirement Act and to benefits under the Social Security Act would be eliminated. Benefits would be provided to children of living employee annuitants. In addition, the prohibition against payment of survivor benefits where a residual lump sum benefit has been elected and paid would be removed with respect to social security equivalent benefits. The legislation would also conform the payment of divorced spouse benefits under the Railroad Retirement Act to the Social Security Act and would

provide a social security equivalent benefit to a spouse of a disabled railroad employee prior to the employee's attainment of age 62 or 60 with 30 years of service.

The proposal would be effective January 1, 1997.